Report of the
Auditor General of Canada
to the House of Commons

Foreword and Main Points

October 2000

This October 2000 Report comprises 8 chapters as well as a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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AUDITOR GENERAL OF CANADA
VÉRIFICATEUR GÉNÉRAL DU CANADA

The Honourable Gilbert Parent, M.P.
Speaker of the House of Commons

I have the honour to transmit herewith my second Report of 2000 to the House of Commons, to be laid before the House in accordance with the provisions of subsection 7(5) of the *Auditor General Act*.

L. Denis Desautels.

L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 17 October 2000

October 2000

Foreword and Main Points

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Report of the Auditor General to the House of Commons for October 2000

Foreword

I am pleased to present the October volume of my 2000 Report. Bound with this Foreword are the Main Points of 8 separately issued chapters:

10. Transport Canada – Airport Transfers: National Airports System
11. Human Resources Development Canada – Grants and Contributions
12. Values and Ethics in the Federal Public Sector
13. Assessment of Financial Management Capabilities in Departments
14. Canadian International Development Agency – Managing Contracts and Contribution Agreements
15. Health Canada – First Nations Health: Follow-up
16. Follow-up of Recommendations in Previous Reports
17. Other Audit Observations

In the first two volumes of my Report each year, it has been my practice to highlight in the Foreword some common themes in the chapters that follow. Specific comment on the results of individual audits I normally reserve for my annual chapter, Matters of Special Importance. However, the issues surrounding grants and contributions warrant particular mention here. While this Report deals with those issues as reflected in our recent audit at Human Resources Development Canada, our work in various departments back to 1977 has identified persistent shortcomings that we continue to find each time we examine grant and contribution programs.

The proper management of grants and contributions is an essential part of good public administration in the federal government. There are large amounts of public funds involved and they should be spent only with great care and appropriate levels of control.

I find our audit observations in Chapter 11 on grants and contributions at HRDC disturbing in the light of good public administration principles. Our work confirmed the findings of the Department's 1999 internal audit, and more. We found breaches of authority, improper payments, limited monitoring, and approvals that had not followed established procedures. Beyond the immediate corrective action it has taken, HRDC needs to make today's extraordinary effort tomorrow's routine and fundamentally change its day-to-day approach to the delivery of grants and contributions.

Our audits have revealed other instances of weak financial management and control related to grants and contributions. Chapter 14, for example, points out weaknesses in CIDA's management of contribution agreements.

Touching also on the need for improvements in financial management, Chapter 10 on our audit of airport transfers highlights the importance of proper financial analysis for decision making and careful oversight to protect federal assets.

Experience has shown repeatedly that as departments focus on improving their services to Canadians, they must balance that objective with the fundamentals of financial management and control. Chapter 13 sets out the results of an assessment of financial management capabilities across a number of departments. We found gaps between current expectations for financial management and the existing capabilities of departments.

It is clear from the work reported in these chapters that the challenges still to be met in improving financial management are substantial.

Transport Canada

Airport Transfers: National Airports System

Chapter 10 - Main Points

10.1 Our audit examined how Transport Canada handled the transfers of Canada's largest and busiest airports between 1992 and 1999. These airports make up Canada's National Airports System. Under the transfer agreements, Transport Canada retains ownership of the airports but leases out their management, operation and development to bodies known as airport authorities. Our audit concentrated on the financial and oversight aspects of airport transfers in the National Airports System (NAS), not on security and safety.

10.2 We found many significant weaknesses in management practices. Among our most important observations are the following:

- Before it started the lease negotiations for each airport transferred in the second round, and any renegotiations, Transport Canada did not determine the fair market value of the airport assets and business opportunities it was transferring. Such information is fundamental to both negotiating and renegotiating leases and, in our view, its absence represents a clear departure from sound management practice. The quality of information for making decisions on such things as rent is significantly impaired as a result.
- The Department has renegotiated four leases, at a cost to the government of about $474 million in forgone rent ($342 million net present value). The renegotiated deals do not adhere to some of the government's key directions. Further, Transport Canada cannot demonstrate how the deals for all of the transferred airports are equitable, uniform, consistent and fair, one with the other, as the government directed.
- As a result of renegotiations, the government has, in effect, agreed to a reduction of future revenues of the Crown and to the funding of significant capital projects. The information presented to Parliament on forgone rent and the funding of capital projects was fragmented, incomplete and, in some years, non-existent.
- From 1992 to 1999, the government continued to provide financial support to most of the transferred airports. It provided to the airport authorities a total of $360 million, including $118 million in rental credits at Lester B. Pearson International Airport toward a number of renovation projects. The government received a net total of $593 million in rent from airport authorities in this period.
- As assessed by its consultants, the Department's preliminary financial results indicated that five years after transferring the first four airports in 1992, the government's most likely financial position varied significantly after each transfer — from better off to worse off. Although the analysis had been completed — as part of three separate studies with a total cost of $680,000 — a year before our audit ended, we found that Treasury Board and Cabinet had not yet seen the results. The Department has yet to conduct any such analysis for any of the other transferred NAS airports.
- We are concerned that eight years into the transfer process, Transport Canada has yet to clearly define its role as landlord and overseer of the National Airports System. Its handling of key emerging issues such as those related to airport improvement fees, subsidiaries and sole-source contracting has generally been inadequate and, until 1997, was virtually non-existent. Treasury Board and/or Cabinet have received little information on these issues, and some of what they have received has been incomplete and inaccurate.

Background and other observations

10.3 Airports in the National Airports System have been transferred in two rounds. In 1992, Transport Canada leased out the management and administration of four major airports — at Montreal (Dorval and Mirabel), Vancouver, Calgary and Edmonton — to four "local airport authorities". The second round began in 1996 with the transfer of Toronto's Lester B. Pearson International Airport. Since then, 12 other airports, including those at Ottawa, Victoria, Winnipeg and Moncton, have been transferred to "Canadian airport authorities". At the end of our audit, the last four NAS airports — Gander International, Québec/Jean-Lesage International, Fredericton and Prince George — remained to be transferred.

10.4 Although Transport Canada began transferring airports in the late 1980s and has been leasing out airports since 1992, only in 1994 was the National Airports Policy issued. The government saw transfers as a means of funding expansion in the vital National Airports System, making airports more competitive and viable and giving communities the flexibility to use them as tools for economic development. At the same time, Transport Canada would be able to oversee the entire System.

10.5 Transport Canada notes that a number of aspects of the transfer initiative have been positive and that airport authorities have made some strategic choices that have also represented difficult operational decisions. These included, for example, the expansion of passenger facilities, liberalization of operating policies and relocation of scheduled traffic from one airport to another.

The Department's responses to our recommendations are included in this chapter. While the Department agrees with the majority of the recommendations and indicates the steps that it is taking or intends to take to address them, it takes a different position on a number of issues as reflected in its response following paragraph 10.106.

Human Resources Development Canada

Grants and Contributions

Chapter 11 - Main Points

11.1 Our audit examined four of the grant and contribution programs included by Human Resources Development Canada (HRDC) in its 1999 internal audit. We concluded that there were widespread deficiencies in the management control frameworks of all four programs. Our findings, which covered the period to December 1999, confirmed — and extended — those of the Department's 1999 internal audit. Among other things, we found breaches of authority, payments made improperly, very limited monitoring of finances and activities, and approvals not based on established processes.

11.2 The results that projects were to achieve were often not defined in terms that could be measured. Even when they were (as in the case of Youth Internship Canada), results were not measured systematically to provide managers with feedback for making necessary improvements and to provide a basis for accountability. Some evaluation of these programs had been done. The evaluations of the Sectoral Partnerships Initiative and Transitional Jobs Fund resulted in some program changes. However, we could not support the Department's findings on the effectiveness of the Transitional Jobs Fund.

11.3 The Department's review of 37 "problem files" identified by its internal audit for further follow-up established few cases where money could be recovered from project sponsors, because most payment errors resulted from inappropriate practices by departmental staff. Many of these practices are not acceptable — proceeding without required approvals, relying on oral contracts and paying for ineligible expenses, for example. Reporting by HRDC on the results of the review focussed on overpayments and provided little information on the problems found.

11.4 Current management is committed to addressing the serious weaknesses in the management control framework in the period up to December 1999 that our audit and the 1999 internal audit identified. HRDC has corrective action planned and being implemented in response to the problems identified in its 1999 internal audit. The actions and plans also address the deficiencies we found in our audit.

11.5 The Department has made good progress toward meeting the commitments in its Six-Point Action Plan announced in February 2000. Management is enhancing the tools and the support available to staff to improve their ability to do their jobs. Work is also proceeding on additional initiatives that expand or complement the original action plan.

11.6 HRDC management will need to sustain its efforts and attention if it is to achieve the broad-based systemic change the action plans envision. Beyond the immediate corrective steps the Department has taken, it needs to make today's extraordinary effort tomorrow's routine and fundamentally change its day-to-day approach to the delivery of grants and contributions. Management and staff of the Department need to continue the current focus on the fundamentals of control. Minimum standards of control must be in place for all projects. However, time and effort needed to review and assess proposals, monitor progress, assess performance, and evaluate results should vary with the amount of federal funding involved and the risks associated with the project.

11.7 HRDC has established an innovative system of tracking performance — one that allows for tracking improvements in the management and administration of grants and contributions. Ongoing performance tracking and internal audit are essential tools for assessing improvements in the management control framework.

Background and other observations

11.8 HRDC spent about $3 billion in 1999-2000 on grants and contributions for programs such as job creation and youth employment, as well as for employment benefits and support measures. We examined in detail four of about 40 grant and contribution programs run by HRDC: the Transitional Jobs Fund and its successor the Canada Jobs Fund, Youth Internship Canada, Social Development Partnerships and the Sectoral Partnerships Initiative.

11.9 HRDC's problems in managing grants and contributions worsened in the 1990s; audits in the late 1990s show the persistence of problems identified in the past. An internal audit in 1991 and its follow-up in 1994 led to little corrective action. Management's priorities then were to implement major policy initiatives and improve service; there was not enough emphasis on maintaining essential controls while red tape was being reduced and service improved.

11.10 More work is required to determine the resources needed to deliver grant and contribution programs. The Department's corrective actions and plans are designed to strengthen capacity by providing staff with appropriate support, training, tools and systems. HRDC is also taking steps to bring in new staff at appropriate levels. It plans to analyze workload to ensure that it has adequate resources in place.

11.11 The programs we audited had made available general information about their existence. For the most part, the promotion of these programs was passive and, in the case of some programs delivered at the local level, varied significantly among regions and local offices. Information was not always provided in a way that would promote equal access to the programs.

The chapter includes the Department's general response and its responses to specific recommendations.

HRDC has responded positively to our findings and recommendations and affirmed that it will continue to sustain the progress shown to date in meeting the commitments of the Action Plan and related initiatives.

Values and Ethics in the Federal Public Sector

Chapter 12 - Main Points

12.1 Canadians expect that the federal public sector will be a world leader in promoting sound values and ethics in government. Ensuring sound values and ethics is a vital part of good governance that supports and respects fundamental democratic values.

12.2 A comprehensive and sustained dialogue with Canadians and throughout the federal public sector is required. We propose a framework for action that includes eight priorities. We suggest that action start with the following two priorities.

- Reinforce leadership for promoting ethical conduct by, for example,
    - clarifying the principle of ministerial responsibility and the responsibilities of officials; and
    - identifying the responsibilities of senior and line managers for promoting sound values and ethics.
- Re-invigorate an extensive dialogue on values and ethics that emphasizes the primacy of the principles of respect for the law, the public interest, and public service as a public trust.

12.3 Sound values and ethics are needed to maintain probity. There is a strong foundation of values and ethics in the federal public sector. This foundation should not be taken for granted. The government is taking steps to maintain sound values and ethics. Most of these measures are limited or in their preliminary stages. To increase the likelihood of success, values and ethics initiatives have to be carefully developed, implemented, and monitored by using the best available practices. A prerequisite for success is the leadership of parliamentarians, ministers and senior officials.

12.4 The federal government needs to develop an implementation plan with deadlines to address values and ethics priorities across the public sector and in federal entities. We will continue to monitor and report to Parliament on values and ethics initiatives in the public sector.

Background and other observations

12.5 We focussed on values and ethics initiatives that promote ethical decision making that is in the public interest. These initiatives would form part of a comprehensive approach to good governance in federal entities.

12.6 In May 1995 we reported to Parliament on ethics and fraud awareness in government. In 1996 the government completed A Strong Foundation: Report of the Task Force on Public Service Values and Ethics (Tait Report). These reports contributed to forging a consensus on the values and ethics issues that need to be addressed in the federal public service.

12.7 Ensuring ethical decision making is the responsibility of all members of the federal public sector and private sector companies as well as organizations and individuals who receive funds from or do business with the public sector.

12.8 Major changes are occurring in the way government organizes and delivers its programs. These changes include deregulation, downsizing, increasing delegation of decision making to officials in the field, contracting out and entering into partnerships with the private sector. As well, the government is using new technologies, and its work force is becoming more mobile and diverse. As a result, the government is increasingly relying on a strong foundation of values and ethics to make decisions in the public interest.

12.9 As part of good governance efforts, several departments are implementing major values and ethics initiatives. Others do not assign a high priority to developing comprehensive values and ethics initiatives. We believe that all entities should objectively assess and report on values and ethics.

The responses of the Privy Council Office, the deputy minister co-champions for values and ethics in the public service, the Secretary of the Treasury Board and the Ethics Counsellor are included at the end of this chapter. They agree with our assessment of the initiatives under way and acknowledge that there is an important need for further work.

Assessment of Financial Management Capabilities in Departments

Chapter 13 - Main Points

13.1 Our audit assessed the financial management capabilities in five government departments against the criteria established in the Financial Management Capability Model published in April 1999. We found that in each department gaps remain between current expectations for financial management and the existing capabilities of the departments. The capabilities needed to meet current expectations are consistent with those we have described in the Control Level of the Financial Management Capability Model.

13.2 We also noted that departments are at the initial stages of developing the capabilities needed to meet the requirements of the government's Financial Information Strategy and the Modernization of Comptrollership initiative. These capabilities are consistent with the capabilities described in the Information Level of the Financial Management Capability Model.

13.3 Based on the level of financial management capabilities in the departments that we audited, the challenges to be met in improving financial management are substantial. Only one department is close to meeting all the government's current expectations and none currently have the capabilities needed to meet the goals of the Financial Information Strategy and Modernization of Comptrollership initiative. Put simply, it will be very difficult to make government more businesslike if stronger financial information is not well integrated into both day-to-day management and accountability reporting to Parliament. The achievement of these capabilities throughout government will require the strong commitment and sustained support of the Treasury Board Secretariat, Privy Council Office and deputy ministers.

13.4 Our Office has expressed concern about the need to improve financial management in government for a number of years. Similarly, the Public Accounts Committee has noted, "There has been a common call for improvements in financial information to support government decision making." We have noted an increase in the number of initiatives being undertaken and a heightened sense of urgency to develop strong financial management capabilities. The government and the departments themselves have much to do in this area. The success of Results for Canadians — A Management Framework for the Government of Canada, the Financial Information Strategy and the Modernization of Comptrollership initiative will depend on this action.

Background and other observations

13.5 Financial management is an important component of what financial and program managers in departments and agencies do in delivering programs and services and exercising stewardship over the resources entrusted to them. An integrated and systematic approach to financial management allows managers to have the information to make sound decisions, manage risks well, and account properly for the use of public resources. Until recently, financial management has focussed on controlling budgets and processing transactions. Today's rapidly changing environment makes it urgent for the government to implement effective financial management.

13.6 We noted that departments had not implemented adequate monitoring of the effectiveness of their control frameworks. Such monitoring, together with providing assurance to senior management that control mechanisms are operating as designed, is an important component of sound management, particularly in a period of significant change that accompanies the implementation of new financial systems.

13.7 One of the most common gaps that we found in departments was the limited ability to combine or integrate financial and operational (non-financial) information. This gap has clear implications for individual departments and the government as a whole. First, if departments cannot integrate this information, they cannot give Parliament and the Canadian public a realistic picture of how much it has actually cost to produce a given result or deliver a given level of service. Second, without integrated information, senior management cannot readily forecast the downstream costs of major decisions — for example, a decision to increase or decrease the level of service of a program.

13.8 We also found that departments had not established a clear vision or strategy for the transformations that are to take place — an essential first step in managing the changes. Similarly, departments have not determined the skills and capacities that are needed to carry out these changes or whether there is a gap between what is needed and what they currently possess. We also noted that departments had not implemented specific measures against which progress in developing strong financial management capabilities can be tracked.

The response of the Treasury Board Secretariat, on behalf of the government and the five departments audited, is included at the end of this chapter. The response indicates that the recommendations are consistent with the current improvement plans and government expectations of sound management practices.

The responses of Canadian International Development Agency, Environment Canada, Fisheries and Oceans, Health Canada and Transport Canada are included in the case studies in the chapter. The responses indicate an intent to address the gaps identified and that in many cases initiatives are already under way.

Canadian International Development Agency

Managing Contracts and Contribution Agreements

Chapter 14 - Main Points

14.1 In CIDA's Geographic programs, contracts and contribution agreements with Canadian executing agencies are used to implement development projects. Where CIDA used a competitive process for selecting executing agencies, with some exceptions the process was properly conducted. However, we observed instances where contracts did not comply with the Treasury Board Contracting Policy or the Government Contracts Regulations.

14.2 An authority framework, similar to that for the contracting process, is not in place for CIDA's contribution agreements. The terms and conditions for grants and contributions related to the Geographic programs are very general and provide no direction on how and when to use contribution agreements. They include a provision that contributions are to be approved in accordance with regular departmental procedures and authorities; however, exceptions can be dealt with internally by CIDA. Consequently, CIDA's use of contribution agreements to select executing agencies often varied from its stated internal policies or practices. CIDA can select executing agencies by means of contribution agreements, which are, in effect, the same as sole-source contracts that would not be permitted under Government Contracts Regulations. This was the case in about half of the contribution agreements we examined.

14.3 CIDA project officers attach considerable importance to monitoring the agreements under their responsibility. They commonly use monitors under contract to review and report on progress, and they insist on receiving reports from Canadian executing agencies as required.

14.4 For the Voluntary Sector program, the Canadian Partnership Branch obtains reasonable information on the financial health of its Canada-based partners. However, limited information is received on projects that were funded, on the amounts spent on them, and on results obtained. CIDA bases its funding primarily on historical levels rather than on partners' performance. More meaningful and accurate information on the Canadian Partnership Branch is needed in CIDA's Performance Report to Parliament.

Background and other observations

14.5 CIDA is responsible for managing about $1.8 billion of Canada's international assistance. Approximately $700 million of that amount goes to Geographic Branches for programs aimed at countries in Asia, Africa and Latin America. Most of this amount is spent through contracts and contribution agreements with third parties, referred to as executing agencies, to deliver development assistance projects. Another $260 million goes to the Canadian Partnership Branch for grants and contributions to organizations to carry out their own aid programs.

14.6 In 1998, our Office published a report that commented on results-based management related to Geographic programs. We concluded that progress in managing for results was evident but uneven.

14.7 This audit focussed on how CIDA's Geographic Branches manage contracting and other types of agreements for goods and services, including the selection of Canadian executing agencies to deliver projects. It also examined the control framework for agreements in the Canadian Partnership Branch's Voluntary Sector program. The audit aimed to assess whether CIDA's contracting/contribution agreement processes respect Government Contracts Regulations, Treasury Board guidelines and its own policies; whether they are fair and transparent; and whether they meet operational requirements and development needs.

The Agency's responses to our recommendations are included in this chapter. The Agency accepts the recommendations and indicates the actions that it is taking or intends to take to address them.

Health Canada

First Nations Health: Follow-up

Chapter 15 - Main Points

15.1 Health Canada has initiated action to address our observations and recommendations on First Nations Health (1997 Report, Chapter 13). However, we are concerned that the Department has not yet made sufficient progress to fix many of the problems we identified. Continued and sustained effort is required to ensure that all the recommendations are fully implemented.

15.2 We found that:

- the point-of-service system, a key mechanism in the administration of pharmacy benefits and the control of prescription drug use, is now fully operational. It provides drug utilization warning messages to assist pharmacists in deciding whether to dispense prescriptions. As a result, a number of prescriptions have not been filled; and
- a pre-determination process for dental benefits, implemented nationally since 1997, has resulted in substantial savings.

15.3 However, we observed that:

- the management of contribution agreements for the delivery of community health programs is still weak;
- the management of transfer agreements still needs improvement; and
- Health Canada has not adequately monitored the drug utilization warning messages that pharmacists have overridden. Nor has it undertaken sufficient analysis of the effectiveness of the messages to determine whether any adjustments are warranted.

Background and other observations

15.4 Health Canada delivers health services and other related services to over 600 First Nations communities. It delivers them mainly through community health programs (including those transferred to community control) and the Non-Insured Health Benefits program, which covers such benefits as prescription drugs, dental care, medical transportation, and other benefits. Together, these services represented spending of just over $1.0 billion in 1998-99.

15.5 Our 1997 audit found that Non-Insured Health Benefits program expenditures were not well managed and, in most areas, not properly controlled. In particular, significant weaknesses in the management of pharmacy benefits allowed clients to access extremely high levels of prescription drugs. We noted numerous reports of prescription drug addiction and prescription-drug-related deaths of First Nations individuals in several provinces. We also found weaknesses in the management of contribution agreements for the delivery of community health programs as well as in the management of transfer agreements.

15.6 Our follow-up found that the Department has made limited progress in ensuring that reports required under separate contribution agreements are provided. We also found that the Department's performance reports contain limited information on the status of community health programs, including outcomes achieved.

15.7 With respect to transfer agreements, we found that community health plans are still not being updated when agreements are renewed, and requirements for audits, annual reports and evaluations often are not met.

15.8 The Department developed and implemented a protocol for following up with clients, physicians, pharmacists and professional bodies on cases that suggest possible prescription drug misuse. This has had some positive impact, with some regions starting to show a decline in the number of cases of individuals accessing large amounts of prescription drugs. However, as management was unsure of the appropriateness of the approach in the absence of either client consent or specific statutory authority for the Non-Insured Health Benefits program, this intervention was stopped in May 1999. There are still cases of program clients accessing large amounts of prescription drugs, and these require follow-up.

15.9 The Department was slow to develop and incorporate an audit strategy based on an appropriate assessment of risks in its new pharmacy and dental claims-processing contract. It also failed to ensure that the contractor perform the on-site audits of pharmacies and dental providers that the contract requires. We found few such audits undertaken since December 1998 to provide assurance that expenditures claimed had been incurred for the intended purposes.

15.10 Progress to improve efficiencies in administering medical transportation benefits has been limited.

Health Canada's responses to our recommendations are included in this chapter. The Department is continuing with corrective action in response to our 1997 recommendations and has agreed to take action in response to our two new recommendations.

Follow-up of Recommendations in Previous Reports

Chapter 16 - Main Points

16.1 This chapter presents our follow-up of six audits originally published between 1995 and 1998. In the final volume of this year's Report, due to be tabled in December 2000, we will publish an additional follow-up chapter and provide a general conclusion of the government's progress in addressing the concerns we raised in previous reports.

16.2 The policy and legislative environment of the financial services sector has changed considerably since our 1995 and 1997 Reports. Canada's regulatory system for this sector is sound and the Office of the Superintendent of Financial Institutions (OSFI) has taken many satisfactory steps to deal with our previous recommendations. However, with all the expected changes that will affect the financial services sector, OSFI's ability to supervise and regulate could be challenged in the short term. Furthermore, in this changing environment, recruiting and retaining employees will become a bigger challenge.

16.3 Although progress has been slow on addressing the recommendations of our November 1995 chapter — Revolving Funds in the Parliamentary System: Financial Management, Accountability and Audit — recent initiatives by the Treasury Board Secretariat substantially address our recommendations.

16.4 The Canada Industrial Relations Board, formerly known as the Canada Labour Relations Board, has made progress in addressing our concerns about financial control problems. Payment to former members was the single biggest expenditure of the Canada Industrial Relations Board's $1.7 million in transition costs. We also observed that the government, as a whole, has not taken adequate action to improve the accountability framework governing travel and hospitality expenditures of senior Governor in Council appointees.

16.5 National Defence has made significant progress in addressing its lack of plans and priorities for its capital acquisition program. The management of individual major capital projects has also improved. The Department has gone beyond its original commitments to make improvements. Nevertheless, officials estimate that the Department is still about $750 million a year short of the amount needed to modernize and maintain readiness. The "hard choices" referred to in 1998 have been identified, but not all of them have been made.

Other Audit Observations

Chapter 17 - Main Points

17.1 The *Auditor General Act* requires the Auditor General to include in his Reports matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

17.2 The "Other Audit Observations" chapter fulfils a special role in the Reports. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments, or they report on audits and studies of issues that relate to operations of the government as a whole. This chapter reports on specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

17.3 The chapter normally contains observations concerning departmental expenditures and/or revenues. The issues addressed generally involve failure to comply with authorities, and the expenditure of money without due regard to economy.

17.4 Observations reported in this chapter cover the following:

- Space was leased at an excessive cost for a Canada Business Service Centre in Sydney, Nova Scotia that was never operated as intended;
- Inappropriate netting of benefit payments obscures the true size of government revenues and expenditures and complicates the evaluation of fiscal measures;
- Government programs and spending for Parc Downsview Park Inc. lack clear parliamentary authority;
- Non-recovery of expenditures for safe drinking water on Indian reserves affected by Manitoba Hydro development; and
- Significant risk that a $113 million relocation project will not adequately address the needs of the Innu.

17.5 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters we did not examine.

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Auditor General of Canada to the House of Commons – 2000
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Rapport du

vérificateur général du Canada

à la Chambre des communes

Avant-propos et Points saillants

Octobre 2000

Le Rapport d'octobre 2000 comporte huit chapitres ainsi que l'Avant-propos et les Points saillants. Pour mieux répondre aux besoins de nos clients, il est disponible sur divers supports. Pour obtenir d'autres documents ou les obtenir sur un autre support, voir la Table des matières et le bon de commande à la fin du présent document.

Dans le présent rapport, le genre masculin est utilisé sans aucune discrimination et uniquement dans le but d'alléger le texte.

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AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

L'honorable Gilbert Parent, député
Président de la Chambre des communes

J'ai l'honneur de vous transmettre ci-joint mon deuxième rapport de l'an 2000 à la Chambre des communes, lequel doit être déposé à la Chambre en conformité avec les dispositions du paragraphe 7(5) de la *Loi sur le vérificateur général.*

Le vérificateur général du Canada,

L. Denis Desautels.

L. Denis Desautels, FCA

OTTAWA, le 17 octobre 2000

Octobre 2000

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Rapport du vérificateur général du Canada à la Chambre des communes — Octobre 2000

Avant-propos

Je suis heureux de présenter le volume d'octobre de mon rapport de l'an 2000. Cet avant-propos est suivi des Points saillants des huit chapitres, qui sont publiés séparément :

10. Transports Canada – Les cessions d'aéroports : le Réseau national d'aéroports
11. Développement des ressources humaines Canada – Les subventions et les contributions
12. Les valeurs et l'éthique dans le secteur public fédéral
13. L'évaluation des capacités de gestion financière des ministères
14. Agence canadienne de développement international – La gestion des marchés et des accords de contribution
15. Santé Canada – La santé des Premières nations : suivi
16. Suivi des recommandations formulées dans des rapports antérieurs
17. Autres observations de vérification

Chaque année, j'ai l'habitude de faire ressortir, dans la section intitulée Avant-propos des deux premiers volumes de mon rapport, quelques-uns des thèmes communs des chapitres qui suivent. Mes commentaires sur les résultats des vérifications individuelles se trouvent habituellement dans le chapitre intitulé « Questions d'une importance particulière » de mon rapport annuel. Cependant, les questions liées aux subventions et aux contributions méritent ici une attention particulière. Le présent rapport de notre récente vérification de Développement des ressources humaines Canada (DRHC) traite de ces questions, mais les travaux que nous avons effectués dans divers ministères depuis 1997 ont révélé des faiblesses persistantes que nous continuons à constater chaque fois que nous examinons les programmes de subventions et de contributions.

Une bonne gestion des subventions et des contributions constitue un élément essentiel d'une saine gestion des finances publiques au gouvernement fédéral. Des fonds publics considérables sont en jeu et c'est pourquoi il faut les dépenser avec le plus grand soin et avoir en place des niveaux de contrôle adéquats.

Les observations du chapitre 11 sur la vérification des subventions et des contributions à DRHC sont perturbantes à la lumière des principes d'une saine gestion des finances publiques. En effet, nos travaux ont confirmé les constatations de la vérification interne de 1999 réalisée par le Ministère, et plus encore. Nous avons constaté des transgressions des autorisations applicables, des paiements effectués de façon incorrecte, une surveillance limitée et des approbations qui n'avaient pas été faites selon les procédures établies. En plus des mesures correctives qu'il a prises, DRHC doit faire en sorte que l'effort extraordinaire déployé aujourd'hui devienne son mode de fonctionnement de demain et il doit modifier de façon radicale son approche quotidienne pour la prestation des subventions et des contributions.

Nos vérifications ont mis au jour d'autres faiblesses de la gestion et du contrôle financiers dans le domaine des subventions et des contributions. Par exemple, le chapitre 14 fait état de faiblesses dans la gestion par l'Agence canadienne de développement international des accords de contribution.

La nécessité d'améliorer la gestion financière a aussi été constatée dans le chapitre 10 sur la vérification des cessions d'aéroports, où nous soulignons l'importance d'effectuer une analyse financière de qualité pour étayer la prise de décision et de surveiller de façon adéquate les biens fédéraux.

L'expérience a maintes fois démontré que lorsque les ministères s'efforcent d'améliorer leurs services aux Canadiens, ils doivent atteindre cet objectif tout en appliquant les principes fondamentaux de la gestion et du contrôle financiers. Le chapitre 13 présente les résultats d'une évaluation des capacités de gestion financière dans certains ministères. Nous avons constaté des écarts entre les attentes actuelles au regard de la gestion financière et les capacités des ministères.

D'après les résultats des travaux communiqués dans ces chapitres, il est clair que l'amélioration de la gestion financière représente encore un défi de taille.

Transports Canada

Les cessions d'aéroports : le Réseau national d'aéroports

Chapitre 10 - Points saillants

10.1 Au cours de notre vérification, nous avons examiné la façon dont Transports Canada a procédé pour céder les aéroports les plus grands et les plus achalandés du Canada entre 1992 et 1999. Ces aéroports constituent le Réseau national d'aéroports du Canada. Aux termes des conventions de cession, Transports Canada demeure propriétaire des aéroports qu'il cède à bail à des organismes appelés administrations aéroportuaires auxquelles il a confié la gestion, l'exploitation et le développement de ces aéroports. Nous nous sommes concentrés sur les aspects financiers et de surveillance des aéroports cédés du Réseau national d'aéroports (RNA) et non sur la sûreté et la sécurité.

10.2 Nous avons trouvé de nombreux points faibles non négligeables dans les pratiques de gestion. Voici quelques-unes de nos plus importantes observations :

- Avant de commencer à négocier les baux pour chaque aéroport cédé de la deuxième série de cessions, et à renégocier d'autres baux, Transports Canada n'a pas déterminé la juste valeur marchande des éléments d'actif ni les possibilités d'affaires des aéroports qu'il cédait. Cette information est fondamentale pour la négociation et la renégociation des baux et, à notre avis, le fait qu'il n'y en ait pas représente un écart évident par rapport aux bonnes pratiques de gestion. La qualité des renseignements nécessaires pour prendre des décisions sur certains aspects comme le loyer s'en trouve donc grandement affaiblie.

- Le Ministère a renégocié quatre baux au coût, pour le gouvernement, d'environ 474 millions de dollars sous forme d'abandon de loyer (valeur actuelle nette de 342 millions de dollars). Les ententes renégociées ne sont pas conformes à certaines directives clés du gouvernement. De plus, Transports Canada ne peut démontrer en quoi les ententes pour tous les aéroports cédés sont équitables, uniformes, cohérentes et justes l'une par rapport à l'autre, comme le gouvernement l'a prescrit.

- Par suite des renégociations, le gouvernement a, de fait, convenu de réduire les futurs revenus de l'État et de financer de grands projets d'immobilisations. L'information présentée au Parlement sur le loyer cédé et le financement de projets d'immobilisations était fragmentaire, incomplète et, certaines années, inexistante.

- De 1992 à 1999, le gouvernement a continué de fournir une aide financière à la plupart des aéroports cédés. Il a fourni aux administrations aéroportuaires une somme totale de 360 millions de dollars, dont 118 millions de dollars sous forme de crédits de loyer à l'Aéroport international Lester-B.-Pearson de Toronto pour contribuer à la réalisation d'un certain nombre de projets de rénovation. Le gouvernement a touché en revenus locatifs un montant total net de 593 millions de dollars des administrations aéroportuaires au cours de cette période.

- Ainsi qu'ils avaient été évalués par les experts-conseils du Ministère, les résultats financiers préliminaires ont révélé que, cinq ans après la cession des quatre premiers aéroports en 1992, la situation financière la plus probable du gouvernement variait grandement à la suite de chaque cession — d'une situation meilleure à une situation « moins avantageuse ». Bien que l'évaluation ait été terminée — dans le cadre de trois études distinctes ayant coûté en tout 680 000 $ — un an avant la fin de notre vérification, nous avons constaté que le Conseil du Trésor et le Cabinet n'en avaient pas encore vu les résultats. Le Ministère n'a pas encore effectué une telle évaluation pour tout autre aéroport cédé du RNA.

- Nous nous soucions du fait que Transports Canada, dans les huit années du processus de cession, n'a pas défini clairement son rôle en tant que locateur et surveillant du Réseau national d'aéroports. Sa façon de traiter les nouvelles questions clés comme celles qui sont liées aux frais d'améliorations aéroportuaires, aux filiales et aux marchés à fournisseur unique s'est révélée en général inadéquate et, jusqu'en 1997, il ne s'en est pratiquement pas occupé. Le Conseil du Trésor et/ou le Cabinet ont reçu peu d'informations sur ces questions et certaines de ces informations étaient incomplètes et inexactes.

Contexte et autres observations

10.3 Il y a eu deux séries de cessions des aéroports du Réseau national d'aéroports. En 1992, Transports Canada a cédé à bail quatre grands aéroports — Montréal (Dorval et Mirabel), Vancouver, Calgary et Edmonton — à quatre « administrations aéroportuaires locales » à qui il a confié la gestion et l'administration de ces aéroports. La deuxième série a débuté en 1996 par la cession de l'Aéroport international Lester-B.-Pearson de Toronto. Depuis lors, 12 autres aéroports, notamment Ottawa, Victoria, Winnipeg et Moncton, ont été cédés à des « administrations aéroportuaires canadiennes ». À la fin de notre vérification, il restait encore à céder les quatre derniers aéroports du RNA — l'Aéroport international de Gander, l'Aéroport international Jean-Lesage de Québec et les aéroports de Fredericton et de Prince George.

10.4 Bien que Transports Canada ait entamé le processus de cession des aéroports vers la fin des années 1980, et qu'il cède des aéroports à bail depuis 1992, ce n'est qu'en 1994 qu'a paru la Politique nationale des aéroports. Pour le gouvernement, les cessions étaient perçues comme un moyen de financer l'expansion de ce réseau vital qu'est le Réseau national d'aéroports, de rendre les aéroports plus concurrentiels et viables et de donner aux collectivités la marge de manœuvre nécessaire pour qu'elles les utilisent comme des outils de développement économique. Par le fait même, Transports Canada aurait la possibilité de surveiller l'ensemble du Réseau.

10.5 Transports Canada signale qu'un certain nombre d'aspects de l'initiative de cession ont été positifs et que les administrations aéroportuaires ont fait des choix stratégiques qui représentaient également des décisions opérationnelles difficiles. Il s'agit, par exemple, de l'agrandissement d'installations pour les passagers, de la libéralisation des politiques opérationnelles et du déplacement du trafic régulier d'un aéroport à un autre.

Les réponses du Ministère à nos recommandations sont incluses dans le présent chapitre. Bien qu'il soit d'accord avec la plupart de nos recommandations et expose les mesures qu'il prend ou entend prendre pour y donner suite, le Ministère a pris une position différente sur un certain nombre de questions, comme il l'exprime dans sa réponse qui suit le paragraphe 10.106.

Développement des ressources humaines Canada

Les subventions et les contributions

Chapitre 11 - Points saillants

11.1 Au cours de notre vérification, nous avons examiné quatre des programmes de subventions et de contributions qui faisaient partie de la vérification interne de 1999 de Développement des ressources humaines Canada (DRHC). Nous avons conclu qu'il y avait des lacunes généralisées au chapitre des cadres de contrôle de gestion des quatre programmes. Nos constatations, qui s'appliquaient à la période se terminant en décembre 1999, confirment celles de la vérification interne de 1999 et vont plus loin. Nous avons notamment relevé des transgressions des autorisations applicables, des paiements effectués de manière inappropriée, un contrôle très restreint des finances et des activités, et des approbations non fondées sur les procédures établies.

11.2 Souvent, les résultats visés par les projets n'étaient pas définis en termes mesurables. Et même lorsque c'était le cas (comme pour le programme Jeunes stagiaires Canada), les résultats n'étaient pas mesurés systématiquement, ce qui empêchait les gestionnaires d'obtenir les renseignements requis pour concevoir des modifications utiles et de disposer des données nécessaires à leur reddition de comptes. Ces programmes avaient fait l'objet d'une certaine évaluation. À la suite de l'évaluation de l'Initiative des partenariats sectoriels et du Fonds transitoire pour la création d'emplois, ces programmes ont subi quelques modifications. Toutefois, nous n'avons pas pu appuyer les constatations du Ministère sur l'efficacité du Fonds transitoire pour la création d'emplois.

11.3 En examinant les 37 dossiers « problématiques » identifiés aux fins de suivi par sa vérification interne, le Ministère n'a relevé que quelques cas où il était possible de recouvrer des fonds auprès des promoteurs de projet, parce que la plupart des paiements erronés étaient attribuables à des pratiques inappropriées des employés du Ministère. Bon nombre de ces pratiques ne sont pas acceptables – aller de l'avant sans les approbations requises, s'appuyer sur des contrats verbaux et rembourser des dépenses non admissibles, par exemple. La communication, par DRHC, des résultats de l'examen était centrée sur les trop-payés et fournissait peu d'information sur les problèmes décelés.

11.4 Les gestionnaires actuels de DRHC se sont engagés à régler les sérieuses faiblesses du cadre de contrôle de gestion qu'avaient signalées la vérification interne et notre vérification pour la période se terminant en décembre 1999. DRHC a planifié et mis en œuvre des mesures correctives en réponse aux problèmes relevés dans le cadre de sa vérification interne de 1999. Les mesures et les plans mis en place visent eux aussi à corriger les lacunes que nous avons cernées dans notre vérification.

11.5 Le Ministère a fait des progrès satisfaisants dans la concrétisation des engagements pris dans son Plan d'action en six points annoncé en février 2000. La direction travaille à améliorer les outils et les mesures de soutien mis à la disposition des employés afin qu'ils puissent mieux s'acquitter de leurs tâches. On travaille également à d'autres initiatives visant à étendre ou à compléter le plan d'action initial.

11.6 Pour concrétiser le profond changement systémique visé par les plans d'action, la direction de DRHC ne devra pas relâcher ses efforts ni son attention. En plus des mesures correctives déjà prises, le Ministère devra faire en sorte que l'effort extraordinaire déployé aujourd'hui devienne son mode de fonctionnement de demain et, pour cela, il devra modifier radicalement son approche quotidienne pour la prestation des subventions et des contributions. Les gestionnaires et les employés du Ministère doivent continuer de centrer leur attention sur les aspects fondamentaux du contrôle. Des normes minimales de contrôle doivent être mises en place pour tous les projets. Toutefois, le temps et les efforts à consacrer à l'examen et à l'évaluation des propositions, au suivi des progrès, à l'évaluation du rendement et à l'analyse des résultats devraient varier selon l'importance des fonds fédéraux en cause et des risques associés au projet.

11.7 DRHC a mis en place un système novateur de suivi du rendement — un système qui permet de noter les améliorations apportées à la gestion et à l'administration des subventions et des contributions. Le suivi continu du rendement et la vérification interne sont des outils essentiels pour l'évaluation des améliorations apportées au cadre de contrôle de gestion.

Contexte et autres observations

11.8 DHRC a consacré en 1999-2000 environ trois milliards de dollars à des subventions et à des contributions à verser pour des programmes, par exemple, de création d'emplois ou d'emploi des jeunes, ainsi que pour des prestations d'emploi et des mesures de soutien. Nous avons examiné en détail 4 des quelque 40 programmes de subventions et de contributions discrétionnaires offerts par DRHC : le Fonds transitoire pour la création d'emplois et le programme qui l'a remplacé, le Fonds du Canada pour la création d'emplois, Jeunes stagiaires Canada, le Programme de partenariats pour le développement social et l'Initiative des partenariats sectoriels.

11.9 Les problèmes qu'éprouve DRHC à gérer ses subventions et ses contributions se sont aggravés au cours des années 1990; des vérifications menées à la fin des années 1990 révèlent la persistance de problèmes déjà cernés. Une vérification interne menée en 1991 et le suivi effectué en 1994 n'ont donné lieu qu'à très peu de mesures correctives. La direction s'employait alors en priorité à mettre en œuvre d'importantes initiatives d'orientation de la politique et à améliorer le service offert; on n'a pas insisté suffisamment sur le maintien des contrôles essentiels dans un contexte de réduction de la bureaucratie et d'amélioration du service.

11.10 Il faut faire encore plus pour déterminer quelles sont les ressources nécessaires pour administrer les programmes de subventions et de contributions. Les plans et les mesures correctives du Ministère visent à renforcer la capacité d'exécution des programmes en donnant aux employés un soutien, une formation, des outils et des systèmes appropriés. DRHC prend également des dispositions pour recruter des employés aux niveaux correspondant à ses besoins. Le Ministère prévoit analyser la charge de travail pour s'assurer que les ressources en place sont suffisantes.

11.11 Pour les programmes que nous avons vérifiés, des renseignements généraux avaient été diffusés afin que les gens puissent en connaître l'existence. Le plus souvent, la promotion de ces programmes se faisait de façon passive et, dans le cas de certains programmes offerts au niveau local, elle variait considérablement selon la région ou le bureau responsable. L'information n'était pas toujours diffusée de manière à favoriser l'égalité d'accès aux programmes.

Le présent chapitre présente une réponse globale du Ministère et des réponses à chacune de nos recommandations.

DRHC a réagi positivement à nos constatations et à nos recommandations. Le Ministère affirme qu'il continuera de progresser au même rythme pour ce qui est de la réalisation des engagements présentés dans son plan d'action et des engagements liés à des initiatives connexes.

Les valeurs et l'éthique dans le secteur public fédéral

Chapitre 12 - Points saillants

12.1 Les Canadiens s'attendent à ce que le secteur public fédéral soit un chef de file mondial en ce qui a trait à la promotion de valeurs saines et de l'éthique au sein du gouvernement. Ces valeurs et cette éthique constituent un élément essentiel d'une saine régie publique qui respecte et appuie les valeurs démocratiques fondamentales.

12.2 Il faut engager un dialogue approfondi et soutenu avec les Canadiens et dans l'ensemble du secteur public fédéral. Nous proposons un cadre d'action comportant huit mesures prioritaires, et suggérons de commencer par les deux priorités suivantes :

- Renforcer le leadership pour ce qui est de promouvoir un comportement conforme à l'éthique, et ce, par exemple,
  - en clarifiant le principe de la responsabilité ministérielle et les responsabilités des hauts fonctionnaires;
  - en déterminant les responsabilités des gestionnaires supérieurs et hiérarchiques à l'égard de la promotion de valeurs saines et de l'éthique.
- Relancer un dialogue approfondi sur les valeurs et l'éthique, qui souligne la primauté des principes suivants : le respect de la loi, l'intérêt public et la fonction publique en tant que bien public.

12.3 Des valeurs et une éthique saines sont essentielles au maintien de la probité. Le secteur public fédéral dispose d'une solide assise au chapitre des valeurs et de l'éthique, mais cela ne devrait pas être tenu pour acquis. Le gouvernement prend actuellement une série de mesures pour préserver cette assise, mais la plupart d'entre elles sont d'une envergure restreinte ou en sont à une étape préliminaire. Pour améliorer les chances de succès, il faut que les initiatives liées aux valeurs et à l'éthique soient élaborées, mises en œuvre et surveillées avec soin, en recourant aux meilleures pratiques possibles. Le leadership des parlementaires, des ministres et des hauts fonctionnaires constitue une condition préalable au succès.

12.4 Le gouvernement fédéral doit établir un plan de mise en œuvre assorti d'échéances afin de traiter des priorités relatives aux valeurs et à l'éthique qui s'appliquent à l'ensemble du secteur public ainsi qu'aux entités fédérales. Nous continuerons de surveiller les initiatives liées aux valeurs et à l'éthique au sein du secteur public et nous continuerons de rendre compte de la situation au Parlement.

Contexte et autres observations

12.5 Notre étude portait sur les initiatives liées aux valeurs et à l'éthique qui favorisent la prise de décisions éthiques conformes à l'intérêt public. Ces initiatives constitueraient une approche exhaustive à l'égard d'une saine régie dans les entités fédérales.

12.6 Le rapport de mai 1995 que nous avons présenté au Parlement comporte un chapitre intitulé « La sensibilisation à l'éthique et à la fraude au gouvernement ». En 1996, le gouvernement a publié *De solides assises — Rapport du Groupe de travail sur les valeurs et l'éthique dans la fonction publique* (le Rapport Tait). Ces deux documents ont contribué à former un consensus sur les questions relatives aux valeurs et à l'éthique qui doivent être réglées dans la fonction publique fédérale.

12.7 Il incombe à tous les membres du secteur public fédéral et des entreprises du secteur privé, ainsi qu'aux organismes et aux particuliers qui reçoivent des fonds du secteur public ou qui font affaire avec celui-ci, de veiller à ce que les décisions prises soient conformes à l'éthique.

12.8 D'importants changements ont actuellement lieu dans la façon dont le gouvernement structure et exécute ses programmes. Parmi ces changements, mentionnons la déréglementation, la réduction de l'effectif, une délégation accrue de pouvoirs décisionnels aux fonctionnaires dans les régions, l'impartition, ainsi que la conclusion de partenariats avec le secteur privé. L'État a en outre recours à des technologies nouvelles, et son effectif devient plus mobile et diversifié. De ce fait, il se fonde de plus en plus sur de solides assises en matière de valeurs et d'éthique pour prendre des décisions qui tiennent compte de l'intérêt public.

12.9 Dans le cadre des efforts de saine gestion qui sont déployés, plusieurs ministères mettent en œuvre d'importantes initiatives en matière de valeurs et d'éthique. D'autres considèrent que l'élaboration de ce genre d'initiatives ne constitue pas une haute priorité. Nous croyons que toutes les entités devraient évaluer objectivement les questions relatives aux valeurs et à l'éthique, et en rendre compte.

Les réponses du Bureau du Conseil privé, des sous-ministres co-champions chargés de promouvoir les valeurs et l'éthique dans la fonction publique, du Secrétariat du Conseil du Trésor et du conseiller en éthique sont insérées à la fin du présent chapitre. Tous sont d'accord avec notre évaluation des initiatives en cours et ils reconnaissent qu'il y a encore beaucoup de travail à accomplir.

L'évaluation des capacités de gestion financière des ministères

Chapitre 13 - Points saillants

13.1 Nous avons évalué les capacités de gestion financière de cinq ministères par rapport aux critères établis dans le Modèle de la capacité de gestion financière qui a été publié en avril 1999. Dans chaque ministère, nous avons constaté des lacunes entre les attentes actuelles à l'égard de la gestion financière et les capacités que possèdent les ministères. Les capacités nécessaires pour répondre aux attentes actuelles sont conformes à celles que nous avons décrites dans le niveau du contrôle du Modèle de la capacité de gestion financière.

13.2 Nous avons également constaté que les ministères commencent à peine à établir les capacités nécessaires pour répondre aux exigences de la Stratégie d'information financière du gouvernement et de l'Initiative de modernisation de la fonction de contrôleur. Ces capacités sont conformes à celles décrites dans le niveau de l'information du Modèle de la capacité de gestion financière.

13.3 Si l'on se fonde sur le niveau des capacités de gestion financière des ministères que nous avons vérifiés, les défis à relever pour améliorer la gestion financière sont énormes. Un seul ministère répond à presque toutes les attentes actuelles du gouvernement et aucun n'a actuellement les capacités nécessaires pour atteindre les objectifs de la Stratégie d'information financière et de l'Initiative de modernisation de la fonction de contrôleur. En bref, il sera très difficile d'assurer dans le secteur public une gestion semblable à celle du secteur privé si l'on n'intègre pas une information financière plus rigoureuse à la gestion quotidienne et à l'information redditionnelle communiquée au Parlement. L'établissement de ces capacités dans l'ensemble du gouvernement exigera un engagement ferme et un appui soutenu du Secrétariat du Conseil du Trésor, du Bureau du Conseil privé et des sous-ministres.

13.4 Le Bureau fait état depuis plusieurs années de la nécessité d'améliorer la gestion financière au gouvernement. De même, le Comité des comptes publics a noté ce qui suit : « on assiste à un appel général à l'amélioration de l'information financière fournie comme aide aux décisions du gouvernement ». Nous avons constaté une augmentation du nombre d'initiatives prises et un sentiment d'urgence accru visant l'élaboration de capacités solides en gestion financière. Le gouvernement et les ministères aussi ont un rôle important à jouer dans ce domaine. Le succès *Des résultats pour les Canadiens et les Canadiennes – Un cadre de gestion pour le gouvernement du Canada,* de la Stratégie d'information financière et de l'Initiative de modernisation de la fonction de contrôleur dépendra de leur action.

Contexte et autres observations

13.5 La gestion financière est un important volet de ce que font les gestionnaires des finances et des programmes des ministères et organismes pour assurer les programmes et les services et exercer une intendance sur les ressources qui leur sont confiées. Une approche systématique et intégrée de la gestion financière permet aux gestionnaires de disposer de l'information voulue pour prendre de bonnes décisions, bien gérer les risques et rendre compte adéquatement de l'utilisation des ressources publiques. Jusqu'à tout récemment, la gestion financière mettait l'accent sur le contrôle des budgets et le traitement des opérations. Dans le contexte d'aujourd'hui, qui évolue rapidement, il est urgent que le gouvernement assure une gestion financière efficace.

13.6 Nous avons noté que les ministères n'avaient pas instauré de surveillance adéquate de l'efficacité de leur cadre de contrôle. Une telle surveillance, ainsi que la communication à la haute direction de l'assurance que les mécanismes de contrôle fonctionnent comme prévu, constitue l'un des éléments importants d'une gestion saine, particulièrement à un moment où la mise en œuvre de nouveaux systèmes financiers entraîne des changements marqués.

13.7 L'une des lacunes les plus courantes que nous ayons constatées dans les ministères est la capacité limitée de combiner ou d'intégrer l'information financière et l'information opérationnelle (non financière). Cette lacune a des répercussions évidentes pour chacun des ministères et le gouvernement dans son ensemble. Tout d'abord, si les ministères ne peuvent intégrer cette information, ils ne peuvent donner au Parlement et au public canadien une image réaliste des coûts réellement engagés pour obtenir un résultat donné ou offrir un niveau donné de service. Ensuite, sans information intégrée, il n'est pas facile pour les cadres supérieurs de prévoir les coûts qui découleront des décisions importantes — par exemple, la décision d'augmenter ou de diminuer le niveau de service d'un programme.

13.8 Nous avons également constaté que les ministères n'avaient pas établi de vision ou de stratégie claires des transformations qui doivent intervenir — une première étape essentielle pour gérer les changements. De même, les ministères n'ont pas déterminé les compétences et les capacités nécessaires pour concrétiser ces changements, ni établi s'il existe une lacune entre ce qui est nécessaire et ce qu'ils possèdent actuellement. Nous avons aussi remarqué que les ministères n'avaient pas pris de mesures particulières pour surveiller les progrès réalisés dans l'établissement de solides capacités de gestion financière.

La réponse du Secrétariat du Conseil du Trésor, au nom du gouvernement et des cinq ministères examinés, figure à la fin du chapitre. Cette réponse indique que les recommandations correspondent aux plans actuels d'amélioration et aux attentes du gouvernement en matière de pratiques de gestion saines.

Les réponses de l'Agence canadienne du développement international, d'Environnement Canada, de Pêches et Océans, de Santé Canada et de Transports Canada sont incluses dans le chapitre, avec les études de cas. Elles indiquent une volonté de combler les lacunes relevées; dans de nombreux cas, des initiatives en ce sens sont déjà en cours.

Agence canadienne de développement international

La gestion des marchés et des accords de contribution

Chapitre 14 - Points saillants

14.1 Dans le cadre des programmes géographiques de l'Agence canadienne de développement international (ACDI), des marchés et des accords de contribution sont conclus avec des agences d'exécution canadiennes pour mettre en œuvre des projets de développement. Lorsque l'Agence a eu recours à des marchés concurrentiels pour la sélection des agences d'exécution, le processus a été bien mené, à quelques exceptions près. Toutefois, nous avons observé des cas où les marchés n'étaient pas conformes à la Politique sur les marchés du Conseil du Trésor ou au *Règlement sur les marchés de l'État.*

14.2 Pour les accords de contribution, l'ACDI n'a pas de cadre des pouvoirs semblable à celui du processus de passation de marché. Les conditions qui s'appliquent aux subventions et aux contributions relatives aux programmes géographiques sont très générales et n'indiquent pas comment ni quand utiliser les accords de contribution. Ces conditions comprennent une disposition selon laquelle les contributions doivent être approuvées en conformité avec les procédures et les pouvoirs ministériels ordinaires; cependant, l'ACDI peut traiter les cas d'exception au sein même de l'Agence. Par conséquent, l'utilisation par l'ACDI des accords de contribution pour la sélection des agences d'exécution s'est souvent écartée des politiques ou pratiques internes énoncées. L'ACDI peut sélectionner les agences d'exécution au moyen d'accords de contribution qui correspondent, en réalité, à des marchés à fournisseur unique, lesquels ne seraient pas autorisés aux termes du *Règlement sur les marchés de l'État*. C'était le cas pour environ la moitié des accords de contribution que nous avons examinés.

14.3 Les agents de projet de l'ACDI accordent une importance considérable à la surveillance des accords dont ils sont responsables. Ils ont couramment recours à des contractuels pour surveiller les progrès et faire rapport sur ceux-ci, et ils insistent pour que les agences d'exécution canadiennes leur soumettent les rapports requis.

14.4 Dans le cas du Programme d'envoi de volontaires, la Direction générale du partenariat canadien obtient une information adéquate sur la santé financière de ses partenaires canadiens. Cependant, elle reçoit peu d'information sur les projets financés, les sommes dépensées et les résultats obtenus. Pour accorder un financement, l'ACDI se fonde surtout sur les niveaux historiques plutôt que sur le rendement de ses partenaires. Le Rapport sur le rendement que l'ACDI présente au Parlement doit fournir une information plus pertinente et exacte sur la Direction générale du partenariat canadien.

Contexte et autres observations

14.5 L'ACDI doit gérer un budget d'environ 1,8 milliard de dollars destiné à l'aide internationale fournie par le Canada. Elle verse environ 700 millions de dollars aux directions générales des programmes géographiques pour des programmes exécutés en Asie, en Afrique et en Amérique latine. La plus grande partie de cette somme est affectée, par l'intermédiaire de marchés et d'accords de contribution avec des tiers appelés agences d'exécution, à des projets d'aide au développement. Une autre tranche de 260 millions de dollars est versée à la Direction générale du partenariat canadien pour les subventions et contributions accordées à des organisations qui exécutent leurs propres programmes d'aide.

14.6 En 1998, le Bureau du vérificateur général a publié un rapport qui présentait des observations sur la gestion axée sur les résultats dans le contexte des programmes géographiques. Nous avions alors conclu qu'il y avait des progrès évidents à ce chapitre, mais que ces progrès étaient inégaux.

14.7 La présente vérification portait sur la manière dont les directions générales des programmes géographiques gèrent les marchés et d'autres types d'accords pour l'acquisition de biens et de services, y compris la sélection des agences d'exécution canadiennes qui mettent en oeuvre les projets. Nous avons aussi examiné le cadre de contrôle des accords de financement du Programme d'envoi de volontaires de la Direction générale du partenariat canadien. La vérification avait pour objet de déterminer si les processus utilisés par l'ACDI pour la passation des marchés et les accords de contribution sont conformes au *Règlement sur les marchés de l'État*, aux lignes directrices du Conseil du Trésor et aux politiques de l'Agence elle-même, si ces processus sont équitables et transparents et s'ils satisfont aux exigences de fonctionnement et aux besoins en matière de développement.

Les réponses de l'Agence à nos recommandations sont intégrées au chapitre. L'Agence accepte les recommandations et précise les mesures qu'elle prend ou compte prendre pour y répondre.

Santé Canada

La santé des Premières nations : suivi

Chapitre 15 - Points saillants

15.1 Santé Canada a pris des mesures afin de donner suite à nos observations et à nos recommandations sur la santé des Premières nations (Rapport de 1997, chapitre 13). Nous craignons toutefois que le Ministère n'ait pas encore fait suffisamment de progrès pour régler nombre des problèmes cernés. Il faut déployer des efforts continus et soutenus pour assurer la mise en oeuvre complète de toutes les recommandations.

15.2 Nous avons constaté :

- que le système de traitement aux points de service, un mécanisme clé pour l'administration des prestations pharmaceutiques et le contrôle de l'utilisation des médicaments prescrits, est maintenant entièrement opérationnel. Ce système génère des messages d'avertissement concernant la consommation de médicaments pour aider les pharmaciens à décider s'il y a lieu de délivrer les ordonnances. Ainsi, un certain nombre d'ordonnances n'ont pas été remplies;
- qu'un processus de prédétermination des soins dentaires, mis en oeuvre à l'échelle nationale en 1997, a permis de réaliser des économies substantielles.

15.3 Cependant, nous avons observé :

- que la gestion des accords de contribution pour l'exécution des programmes de santé communautaire est encore faible;
- qu'il faut encore améliorer la gestion des ententes de transfert;
- que Santé Canada n'a pas suffisamment surveillé les cas où les pharmaciens n'ont pas tenu compte des messages d'avertissement concernant la consommation de médicaments, ni entrepris une analyse appropriée de l'efficacité des messages pour déterminer s'il y a lieu d'apporter des changements.

Contexte et autres observations

15.4 Santé Canada offre des services de santé et d'autres services connexes à plus de 600 collectivités des Premières nations, principalement par l'entremise de programmes de santé communautaire (y compris ceux dont la responsabilité a été transférée aux collectivités) et du Programme des services de santé non assurés, qui rembourse des prestations comme les médicaments prescrits, les soins dentaires, le transport pour des raisons de santé et d'autres prestations. Ensemble, ces services représentaient des dépenses d'un peu plus d'un milliard de dollars en 1998-1999.

15.5 Notre vérification de 1997 nous a permis de constater que les dépenses liées au Programme des services de santé non assurés n'étaient pas bien gérées et, dans la plupart des cas, n'étaient pas bien contrôlées. Plus précisément, d'importantes lacunes dans la gestion des prestations pharmaceutiques permettaient aux clients de se procurer des quantités extrêmement importantes de médicaments prescrits. Nous avons pris connaissance de nombreux rapports faisant état de toxicomanie due aux médicaments prescrits et de décès liés à ceux-ci parmi les membres des Premières nations dans plusieurs provinces. Nous avons également relevé des lacunes dans la gestion des accords de contribution prévus pour l'exécution des programmes de santé communautaire ainsi que dans la gestion des ententes de transfert.

15.6 Notre suivi a révélé que le Ministère avait fait peu de progrès pour s'assurer que les rapports exigés en vertu des accords de contribution distincts sont fournis. Nous avons aussi constaté que les rapports sur le rendement du Ministère contiennent peu d'information sur la situation des programmes de santé communautaire, y compris les résultats obtenus.

15.7 Quant aux ententes de transfert, nous avons constaté que les plans de santé communautaire ne sont toujours pas mis à jour lors du renouvellement des ententes et que les exigences en matière de vérifications, de rapports annuels et d'évaluations sont rarement respectées.

15.8 Le Ministère a élaboré et mis en oeuvre un protocole de suivi auprès des clients, des médecins, des pharmaciens et des organismes professionnels pour les cas laissant supposer l'éventualité d'un usage à mauvais escient de médicaments prescrits. Cette mesure a eu un effet positif; dans certaines régions, le nombre de personnes se procurant de grandes quantités de médicaments prescrits a commencé à décliner. Cependant, puisque la direction doutait du caractère approprié de l'approche en l'absence du consentement du client ou d'une autorisation législative explicite pour le Programme des services de santé non assurés, on a mis fin à cette mesure en mai 1999. Il y a encore des clients du Programme qui se procurent de grandes quantités de médicaments prescrits, et ces cas nécessitent un suivi.

15.9 Le Ministère a tardé à élaborer une stratégie de vérification fondée sur une évaluation appropriée des risques et à l'intégrer à son nouveau contrat de traitement des demandes de remboursement des pharmaciens et des fournisseurs de soins dentaires. Il n'a pu également s'assurer que l'entrepreneur effectue les vérifications sur place des pharmacies et des fournisseurs de soins dentaires exigées par le contrat. Nous avons constaté que peu de vérifications avaient été effectuées depuis décembre 1998 pour fournir l'assurance que les dépenses réclamées avaient été engagées aux fins visées.

15.10 Peu de progrès ont été réalisés pour améliorer l'efficience de l'administration des prestations de transport pour des raisons de santé.

Les réponses de Santé Canada à nos recommandations sont incluses dans le présent chapitre. Le Ministère continue de prendre des mesures correctives en réponse à nos recommandations de 1997 et il a accepté de donner suite à nos deux nouvelles recommandations.

Suivi des recommandations formulées dans des rapports antérieurs

Chapitre 16 - Points saillants

16.1 Le chapitre présente les suivis de six vérifications dont les résultats ont été signalés dans des rapports publiés entre 1995 et 1998. Dans le dernier volume du rapport de cette année, qui doit être déposé en décembre 2000, nous publierons un autre chapitre de suivis et présenterons une conclusion globale sur les progrès qu'a réalisés le gouvernement pour donner suite aux préoccupations que nous avions exprimées dans des rapports antérieurs.

16.2 Le cadre législatif et le contexte politique au sein duquel le secteur des services financiers évolue ont connu de grands changements depuis la publication de nos rapports de 1995 et de 1997. Le Canada est doté d'un solide cadre de réglementation pour ce secteur. Le Bureau du surintendant des institutions financières (BSIF) a pris de nombreuses mesures satisfaisantes pour mettre en oeuvre nos recommandations précédentes. Cependant, avec tous les changements prévus qui auront un effet sur le secteur des services financiers, la capacité de surveillance et de réglementation du BSIF pourrait être mise à l'épreuve à court terme. De plus, dans ce milieu en évolution, le recrutement et le maintien en poste d'employés seront un défi de taille à relever.

16.3 Malgré la lenteur des progrès relatifs aux recommandations contenues dans notre chapitre du Rapport de novembre 1995 intitulé « Les fonds renouvelables dans le régime parlementaire : Gestion financière, responsabilisation et vérification », les mesures récentes prises par le Secrétariat du Conseil du Trésor y répondent en grande partie.

16.4 Le Conseil canadien des relations industrielles, anciennement le Conseil des relations du travail, a fait des progrès pour donner suite à nos préoccupations à l'égard des problèmes de contrôle financier. Le paiement des frais des anciens membres constitue la principale dépense au titre des coûts de transition de 1,7 million de dollars du Conseil canadien des relations industrielles. Nous avons également constaté que, dans l'ensemble, le gouvernement n'a pas pris de mesures adéquates afin d'améliorer le cadre redditionnel régissant les dépenses de voyage et d'accueil des hauts fonctionnaires nommés par le gouverneur en conseil.

16.5 La Défense nationale a accompli des progrès marqués pour traiter le manque de plans et de priorités dans son programme d'acquisition de biens d'équipement. La gestion de grands projets d'acquisitions particuliers s'est aussi améliorée. Le Ministère est allé au-delà de ses engagements originaux pour mettre en oeuvre des améliorations. Cependant, selon les représentants du Ministère, il manque, chaque année, environ 750 millions de dollars pour moderniser et maintenir l'état de préparation des Forces. Les « choix difficiles » dont il était question en 1998 ont été cernés, mais ils n'ont pas tous été faits.

Autres observations de vérification

Chapitre 17 - Points saillants

17.1 La *Loi sur le vérificateur général* exige du vérificateur général qu'il inclue dans ses rapports les questions d'importance qui, à son avis, devraient être portées à l'attention de la Chambre des communes.

17.2 Le chapitre consacré aux « Autres observations de vérification » joue un rôle particulier dans les rapports. D'autres chapitres décrivent habituellement les constatations faites lors des vérifications intégrées que nous avons effectuées dans des ministères particuliers, ou bien ils donnent un compte rendu de vérifications et d'études qui portent sur des questions relatives aux activités du gouvernement dans son ensemble. Dans ce chapitre, nous faisons rapport sur des questions précises dont nous avons pris connaissance au cours de nos vérifications financières et de nos vérifications de conformité aux autorisations des comptes publics du Canada, des états financiers des sociétés d'État et d'autres entités ou au cours de nos vérifications de l'optimisation des ressources.

17.3 Le chapitre renferme habituellement des observations qui se rapportent aux dépenses ou aux recettes des ministères. En général, les questions traitées portent sur la non-conformité aux autorisations ainsi que sur les dépenses de deniers publics sans souci de l'économie.

17.4 Dans ce chapitre, nos observations portent sur les sujets suivants :

- La location de locaux à un prix excessif pour un Centre de services aux entreprises du Canada à Sydney, en Nouvelle-Écosse, qui n'a jamais fonctionné comme prévu;
- La déduction de prestations des recettes, contrairement au traitement comptable recommandé, masque l'envergure réelle des recettes et dépenses du gouvernement et complique l'évaluation des mesures budgétaires;
- Il n'y pas d'autorisation parlementaire claire pour les programmes et les dépenses au titre de Parc Downsview Park inc.;
- Le non-recouvrement des dépenses engagées pour l'alimentation en eau potable des réserves indiennes touchées par des projets d'aménagement de Manitoba Hydro;
- Le risque élevé qu'un projet de réinstallation de 113 millions de dollars ne réponde pas adéquatement aux besoins des Innus.

17.5 Même si les observations de vérification particulières signalent des questions importantes, le lecteur ne doit pas s'en servir pour tirer des conclusions sur des points que nous n'avons pas examinés.

Rapport du vérificateur général du Canada à la Chambre des communes – 2000
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Report of the
Auditor General of Canada
to the House of Commons

Chapter 10
Transport Canada – Airport Transfers: National Airports System

October 2000

This October 2000 Report comprises 8 chapters as well as a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 10

Transport Canada

Airport Transfers: National Airports System

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Transport Canada

Airport Transfers: National Airports System

Main Points

10.1 Our audit examined how Transport Canada handled the transfers of Canada's largest and busiest airports between 1992 and 1999. These airports make up Canada's National Airports System. Under the transfer agreements, Transport Canada retains ownership of the airports but leases out their management, operation and development to bodies known as airport authorities. Our audit concentrated on the financial and oversight aspects of airport transfers in the National Airports System (NAS), not on security and safety.

10.2 We found many significant weaknesses in management practices. Among our most important observations are the following:

- Before it started the lease negotiations for each airport transferred in the second round, and any renegotiations, Transport Canada did not determine the fair market value of the airport assets and business opportunities it was transferring. Such information is fundamental to both negotiating and renegotiating leases and, in our view, its absence represents a clear departure from sound management practice. The quality of information for making decisions on such things as rent is significantly impaired as a result.
- The Department has renegotiated four leases, at a cost to the government of about $474 million in forgone rent ($342 million net present value). The renegotiated deals do not adhere to some of the government's key directions. Further, Transport Canada cannot demonstrate how the deals for all of the transferred airports are equitable, uniform, consistent and fair, one with the other, as the government directed.
- As a result of renegotiations, the government has, in effect, agreed to a reduction of future revenues of the Crown and to the funding of significant capital projects. The information presented to Parliament on forgone rent and the funding of capital projects was fragmented, incomplete and, in some years, non-existent.
- From 1992 to 1999, the government continued to provide financial support to most of the transferred airports. It provided to the airport authorities a total of $360 million, including $118 million in rental credits at Lester B. Pearson International Airport toward a number of renovation projects. The government received a net total of $593 million in rent from airport authorities in this period.
- As assessed by its consultants, the Department's preliminary financial results indicated that five years after transferring the first four airports in 1992, the government's most likely financial position varied significantly after each transfer — from better off to worse off. Although the analysis had been completed — as part of three separate studies with a total cost of $680,000 — a year before our audit ended, we found that Treasury Board and Cabinet had not yet seen the results. The Department has yet to conduct any such analysis for any of the other transferred NAS airports.
- We are concerned that eight years into the transfer process, Transport Canada has yet to clearly define its role as landlord and overseer of the National Airports System. Its handling of key emerging issues such as those related to airport improvement fees, subsidiaries and sole-source contracting has generally been inadequate and, until 1997, was virtually non-existent. Treasury Board and/or Cabinet have received little information on these issues, and some of what they have received has been incomplete and inaccurate.

Background and other observations

10.3 Airports in the National Airports System have been transferred in two rounds. In 1992, Transport Canada leased out the management and administration of four major airports — at Montreal (Dorval and Mirabel), Vancouver, Calgary and Edmonton — to four "local airport authorities". The second round began in 1996 with the transfer of Toronto's Lester B. Pearson International Airport. Since then, 12 other airports, including those at Ottawa, Victoria, Winnipeg and Moncton, have been transferred to "Canadian airport authorities". At the end of our audit, the last four NAS airports — Gander International, Québec/Jean-Lesage International, Fredericton and Prince George — remained to be transferred.

10.4 Although Transport Canada began transferring airports in the late 1980s and has been leasing out airports since 1992, only in 1994 was the National Airports Policy issued. The government saw transfers as a means of funding expansion in the vital National Airports System, making airports more competitive and viable and giving communities the flexibility to use them as tools for economic development. At the same time, Transport Canada would be able to oversee the entire System.

10.5 Transport Canada notes that a number of aspects of the transfer initiative have been positive and that airport authorities have made some strategic choices that have also represented difficult operational decisions. These included, for example, the expansion of passenger facilities, liberalization of operating policies and relocation of scheduled traffic from one airport to another.

The Department's responses to our recommendations are included in this chapter. While the Department agrees with the majority of the recommendations and indicates the steps that it is taking or intends to take to address them, it takes a different position on a number of issues as reflected in its response following paragraph 10.106.

Introduction

10.6 Since 1992, Transport Canada has been transferring the management and operation of Canada's largest and busiest airports to airport authorities — not-for-profit organizations created specifically to run and develop the airports that make up the National Airports System (NAS). They are meant to represent the interests of the municipalities served by the airports and the interests of other stakeholders such as boards of trade, chambers of commerce and other local socio-economic groups (see Exhibit 10.1).

10.7 Each of the 26 airports in the NAS either handles more than 200,000 passengers every year for at least three consecutive years or serves a provincial or territorial capital (see Exhibit 10.2). Collectively, the NAS airports handle more than 90 percent of air passenger traffic in Canada. The government considers them to be the airports most essential to Canada's air transportation.

10.8 Transferring its responsibility for operating NAS airports and divesting its ownership of more than 100 other airports to local governments or community organizations is the last step in the government's withdrawal from air transportation operations. In 1988 it privatized Air Canada, and in 1996 it sold its civil air navigation system to NAV CANADA. However, Transport Canada's mandate to regulate the safety and security of air transportation has not changed. It must still ensure that transferred airports operate in a safe and secure manner.

Transfer model for airports in the National Airports System is unique

10.9 In transferring the NAS airports, the federal government enters into long-term lease arrangements with airport authorities but retains ownership of the airports. The term of the leases is 60 years, with an option to renew for an additional 20 years.

10.10 The NAS airports transferred so far represent billions of dollars in airport revenues and other business opportunities such as hotels, restaurants and retail concessions. Airport authorities can also create subsidiaries with the ability to generate even more revenue from "off-airport" business activities. NAS airports have their own regional economic realities and are at different stages of

The airports in the National Airports System transferred so far represent billions of dollars in airport revenues and other business opportunities such as hotels, restaurants and retail concessions.

Exhibit 10.1

About Airport Authorities

The first round of airport transfers were those to local airport authorities (LAAs) in 1992. The second round of airport transfers, to Canadian airport authorities (CAAs), was intended to follow the 1994 National Airports Policy and the Public Accountability Principles. Both LAAs and CAAs are constituted, for the most part, under the *Canada Corporations Act* and pursuant to by-laws approved by the Minister of Transport. An airport authority is intended to be a not-for-profit business entity created under federal/provincial legislation, as required, to manage and operate a local airport system and associated business enterprises. Local municipalities and various groups nominate members to the boards of directors of LAAs and CAAs. Virtually all authorities include two or three federal government representatives, who do not report to the federal government.

Airport authorities are responsible for all airport operations and for capital projects such as expanding terminal buildings and improving runways. Among other things, they are also responsible for providing emergency services, developing airport lands for various uses (for example, hotels and other commercial activity) and for renting space used for shops, restaurants and the many other businesses that serve the travelling public.

Airport authorities – LAAs and CAAs – are largely monopolies and enjoy a captive market. They can, without regulation, set fees (for example, landing fees) to fund capital works and operations at airports, make any type of investment, and accumulate large reserves, tax-free. Thus, many large airports in the NAS have been given a financial position that enables them to carry out very large projects in a short period of time.

Source: Transport Canada

Introduction

10.6 Since 1992, Transport Canada has been transferring the management and operation of Canada's largest and busiest airports to airport authorities — not-for-profit organizations created specifically to run and develop the airports that make up the National Airports System (NAS). They are meant to represent the interests of the municipalities served by the airports and the interests of other stakeholders such as boards of trade, chambers of commerce and other local socio-economic groups (see Exhibit 10.1).

10.7 Each of the 26 airports in the NAS either handles more than 200,000 passengers every year for at least three consecutive years or serves a provincial or territorial capital (see Exhibit 10.2). Collectively, the NAS airports handle more than 90 percent of air passenger traffic in Canada. The government considers them to be the airports most essential to Canada's air transportation.

10.8 Transferring its responsibility for operating NAS airports and divesting its ownership of more than 100 other airports to local governments or community organizations is the last step in the government's withdrawal from air transportation operations. In 1988 it privatized Air Canada, and in 1996 it sold its civil air navigation system to NAV CANADA. However, Transport Canada's mandate to regulate the safety and security of air transportation has not changed. It must still ensure that transferred airports operate in a safe and secure manner.

Transfer model for airports in the National Airports System is unique

10.9 In transferring the NAS airports, the federal government enters into long-term lease arrangements with airport authorities but retains ownership of the airports. The term of the leases is 60 years, with an option to renew for an additional 20 years.

10.10 The NAS airports transferred so far represent billions of dollars in airport revenues and other business opportunities such as hotels, restaurants and retail concessions. Airport authorities can also create subsidiaries with the ability to generate even more revenue from "off-airport" business activities. NAS airports have their own regional economic realities and are at different stages of

The airports in the National Airports System transferred so far represent billions of dollars in airport revenues and other business opportunities such as hotels, restaurants and retail concessions.

Exhibit 10.1

About Airport Authorities

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Source: Transport Canada

Airport authorities pay Transport Canada nothing up front for either the use of the airports or the rights to attendant business opportunities — which include the power to set their own user fees.

growth and expansion. Airport authorities pay Transport Canada nothing up front for either the use of the airports or the rights to attendant business opportunities — which include the power to set their own user fees. Instead, the intent is that the government will receive its due consideration in rent payments over the 60-year term of each lease.

As owner/landlord the government is entitled to receive rent

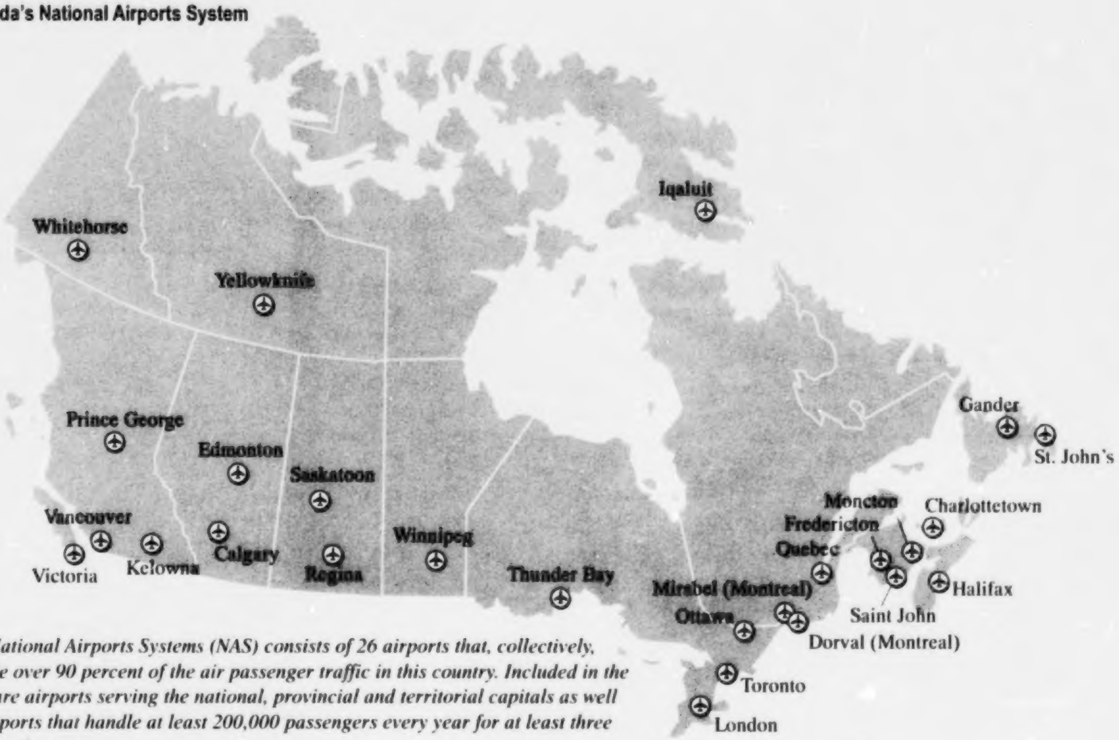
10.11 As owner/landlord of transferred airports in the National Airports System, the government is entitled to receive rent from each airport authority for the use of land and airport facilities. In 1999, the government netted over $170 million in rent. This was more than a quarter of the cumulative $593 million net total it had received since the transfer process began in 1992. We note that most NAS transfers were made in the last three years, and the government has renegotiated rent reductions in some of them, bringing in less revenue as a result (see paragraph 10.55).

Two rounds of transfers to date

10.12 The NAS airports have been transferred in two rounds. The first began in 1992, when Transport Canada leased out the management and administration of four major airports — at Montreal (Dorval and Mirabel are considered one airport), Vancouver, Calgary and Edmonton — to four local airport authorities (LAAs). The second round began in 1996 with the transfer of Toronto's Lester B. Pearson

Exhibit 10.2

Canada's National Airports System


Iqaluit
Whitehorse
Yellowknife
Prince George
Edmonton
Saskatoon
Vancouver
Victoria
Kelowna
Calgary
Regina
Winnipeg
Thunder Bay
Gander
St. John's
Moncton
Charlottetown
Fredericton
Quebec
Halifax
Mirabel (Montreal)
Ottawa
Saint John
Dorval (Montreal)
Toronto
London

The National Airports Systems (NAS) consists of 26 airports that, collectively, handle over 90 percent of the air passenger traffic in this country. Included in the NAS are airports serving the national, provincial and territorial capitals as well as airports that handle at least 200,000 passengers every year for at least three consecutive years.

Source: Transport Canada, February 2000

International Airport to a Canadian airport authority (CAA). The change from LAA to CAA reflects the government's introduction of the National Airports Policy in 1994 (see Exhibit 10.3). The Policy defined Canada's National Airports System for the first time. The NAS included the four airports leased in 1992, and the federal government noted that it would lease out all remaining NAS airports along the same lines. However, all new airport authorities (CAAs) would be expected to follow Public Accountability Principles and adhere to a new standard formula for calculating rent payable to the government.

In February 2000, four airports remained to be transferred

10.13 Although the National Airports Policy anticipated that all 26 NAS airports would be transferred by 31 March 2000 (see Exhibit 10.4), in February 2000 there were still four to be transferred (at Quebec, Fredericton, Gander and Prince George). According to Transport Canada, there are several reasons why the four airports remain. The Department notes that in one case, until recently there was no local interest in taking over the airport. It further notes that because these are smaller airports, their long-term financial viability is a concern. In 1998, the government directed Transport Canada to make the four airports self-sustaining by March 2003 and has extended their transfer deadline accordingly.

Focus of the audit

10.14 We last audited airport transfers in 1993, and reported the very preliminary results of the first round of transfers. Now, seven years later, we are able to provide additional information on the results of the first round as well as on NAS transfers in general (to February 2000).

10.15 Our overall objective for the audit was to examine Transport Canada's management and administration of airport transfers since the first round in 1992, including any renegotiations. We also took a preliminary look at its performance in overseeing the financial viability and integrity of the National Airports System and discharging its responsibilities as landlord of the airport facilities. We did not review the safety and security aspects of airport operations.

10.16 We focussed our audit on eight of the largest airports: those at Victoria, Vancouver, Edmonton, Calgary, Toronto, Ottawa, Montreal (Dorval and Mirabel) and Moncton. All are part of the National Airports System, representing 85 percent of its traffic in 1998 and just about all of Transport Canada's lease revenues. We looked at Transport Canada's adherence to government directions and to key financial principles established for the transfers. We also looked at its new role as landlord of the transferred facilities and overseer of the National Airports System and at how it was dealing with emerging issues of governance and accountability. In doing so, we considered the transfer arrangements and any renegotiated arrangements for each airport.

10.17 More details about the audit objective and scope (including the areas we did not examine) are in **About the Audit** at the end of this chapter.

Observations and Recommendations

10.18 The observations and recommendations that follow are not intended to suggest that the government terminate the transfer initiative or take back the airports it has already transferred. However, the need to address observed shortcomings is a pressing one. Leases run for 60 years; some have already been renegotiated, and the government has given a qualified undertaking to renegotiate with at least three more airport authorities under certain conditions. Transport Canada is also being pressured by more authorities to enter into renegotiations. Proper systems and

The government has given a qualified undertaking to renegotiate with at least three more airport authorities under certain conditions.

Exhibit 10.3

Six Key Components of the Policy Framework for Airport Transfers

1987 - Guiding Principles (LAAs)

Some examples:
- No increase in funding by the government
- Authorities subject to the *Federal Competition Act*
- Not-for-profit corporation
- Authorities to operate under terms and conditions of the operating certificate and under the safety and security regulations
- Government to get a reasonable compensation for any facility transferred
- Many others

1989 - Supplementary Principles (LAAs)

Some examples:
- Airports to be leased on a long-term basis and valued on the basis of fair market value with consideration of potential earnings
- As a general rule, authorities to be self-sufficient
- Authorities to operate at arm's length from government without financial recourse to it
- Board members must be Canadians, nominated by municipal governments and other parties such as chambers of commerce and boards of trade
- Airports to be operated with flexibility, efficiency and affordability by local community representatives to ensure better accountability to public
- Many others

1990 to 1998 - Other Government Directions (LAAs & CAAs)

Some examples:
- Airport transfers should continue to reflect the principles of equity, consistency, uniformity and fairness
- Five-year performance review
- Requirement for self-sufficiency is deferred for some airports via renegotiation of leases
- Federal government be no worse off
- Blanket authority to negotiate 16 transfer deals without airport-specific Treasury Board approval
- Specific components of lease can be negotiated or are predetermined and fixed
- Renegotiate after five years if minimum passenger level not met (only for one airport)
- Reopen long-term agreements to provide financial support at viable airports
- Many others

1994 - National Airports Policy (CAAs)

Some examples:
- Federal government to maintain its role as regulator
- Federal government to retain ownership of the 26 NAS airports and guarantee the integrity and long-term viability of the System
- Airports to meet the needs of users and their communities they serve
- Current levels of service adjusted to meet demand and existing user fees to be applied more widely
- As a general rule, authorities to be self-sufficient five years after transfer
- Many others

1994 - Public Accountability Principles (CAAs)

Some examples:
- Not-for-profit corporation
- Board of Directors includes two or three federal nominees
- Equitable access to all carriers
- Reasonable user charges
- Engage in activities consistent with its purpose
- General practice to tender contracts
- Declarations of business activities to avoid real or perceived conflict of interest
- Community consultations
- Many others

1994 - Fundamental Principles for the Creation and Operation of Canadian Airport Authorities (CAAs)

Some examples:
- Airports to be leased on a long-term basis
- The financial terms of the airport transfer to the authority to result in fair value for the federal government with appropriate consideration to the airport's future earning potential
- As a general rule, authorities to be self-sufficient
- Authorities to operate at arm's length from government, consistent with the long-term lease, without any further recourse to the federal government
- Board members to be Canadians, nominated by federal, provincial and municipal governments and other parties such as chambers of commerce and boards of trade
- Airports to be operated with flexibility, efficiency and affordability by local community representatives to ensure better accountability to public.
- Many others

practices ought to be in place to complete both the last four NAS transfers and any future renegotiations and to ensure that Transport Canada fulfils all of its responsibilities for oversight and governance after transfer.

Policy Aspects of the National Airports System

A comprehensive national policy on airports did not exist until 1994

10.19 Although Transport Canada began the process of transferring airports in the late 1980s and has been leasing out airports since 1992, only in 1994 did it indicate a need for a National Airports Policy. At the time, no statutory, regulatory or policy framework clearly defined Transport Canada's role in operating airports. According to the Department, the absence of a clearly defined policy in this area had led it to make ad hoc decisions.

10.20 Transport Canada also noted that in making ad hoc decisions, it had for over 60 years assumed more and more responsibility for airports. It assumed this responsibility in a patchwork way because there was neither a clearly defined role nor a coherent vision of an airport system to guide these decisions.

10.21 In July 1994, however, the government's National Airports Policy defined Canada's National Airports System for the first time. This Policy was part of the National Air Transportation Strategy, which set out a framework for the government to withdraw from the operation of airports and the air navigation system.

Policy framework for transfers has six components

10.22 The policy framework for airport transfers is a complex one that has evolved over time. It has six components: the National Airports Policy, four sets of principles, and a number of specific government directions issued between 1990 and 1998 for either individual airports or groups of airports (see Exhibit 10.3). In February 2000, the six components of the framework were:

- eight guiding principles (introduced in 1987);

Exhibit 10.4

Status of NAS Airport Transfers at February 2000

Airports transferred to	Airport	Date of Transfer
Local airport authorities (LAAs)	Calgary International	July 1992
	Mirabel and Dorval (Montreal)	August 1992
	Edmonton International	August 1992
	Vancouver International	July 1992
Canadian airport authorities (CAAs)	Lester B. Pearson International	December 1996
	Winnipeg International	January 1997
	Ottawa International	February 1997
	Victoria International	April 1997
	Greater Moncton	September 1997
	Thunder Bay	September 1997
	London International	August 1998
	St. John's International	December 1998
	Saskatoon International	January 1999
	Charlottetown	March 1999
	Regina	May 1999
	Saint John	June 1999
	Halifax International	February 2000
Territories	Yellowknife	July 1995
	Whitehorse	October 1996
	Iqaluit	July 1995[1]
Airports not yet transferred	Gander International	
	Jean-Lesage International	
	Fredericton	
	Prince George	
Municipal Airports	Kelowna International[2]	

Notes: 1 This airport, located in the capital of the Territory of Nunavut, became a NAS airport as of March 1999.

2 The Kelowna Internatinal Airport is part of the NAS because it handles more than 200,000 passengers every year for at least three consecutive years. A long-term lease agreement was signed with the City of Kelowna in 1946.

Source: Transport Canada

- 36 supplementary principles (1989);
- the National Airports Policy (1994);
- 36 Fundamental Principles for the Creation and Operation of Canadian Airport Authorities (1994);
- Public Accountability Principles (1994); and
- other government directions (1990 to 1998).

10.23 The guiding and supplementary principles. Cabinet approved a set of eight guiding principles in 1987 to guide the establishment of airport authorities and the transfer negotiations. These were followed in 1989 by 36 supplementary principles intended to give Transport Canada more direction on negotiating the first round of transfers. According to Transport Canada, the Fundamental Principles for the Creation and Operation of Canadian Airport Authorities and the Public Accountability Principles superseded the 1987 guiding principles and the 1989 supplementary principles. Nonetheless, it appears that both sets of principles (the 1987 guiding principles and the 1989 supplementary principles) still exist and apply in full to one LAA (Montreal). We asked Transport Canada what principles apply to the other three LAAs, given that renegotiations occurred after the issuance of the National Airports Policy. It informed us that to the extent that the legal documents amending the leases replaced the 1987 and 1989 principles with the 1994 principles, or are in addition to the 1987 and 1989 principles, the 1994 principles were applied to renegotiated leases. As a result, some of the 1987 and 1989 principles continue to apply to LAAs who did not agree to replace them with the 1994 principles.

The National Airports Policy called for Transport Canada to continue to own airports in the System to guarantee the integrity and long-term viability of the System.

10.24 The guiding and the supplementary principles articulated a number of expectations — that, for example:

- the government's overall funding requirement for airports would not increase in the long term as a result of transfers;
- the valuation of the airports to be transferred would be on the basis of their fair market value, with proper consideration of their earning potential;
- airport authorities would be financially viable; and
- airport authorities would operate at arm's length from government and without financial recourse to it.

10.25 These principles also covered a number of non-financial items, such as:

- the transfer of airports to not-for-profit entities;
- a minimum two-year job guarantee for indeterminate Transport Canada employees affected by transfer; and
- a requirement for adherence to Transport Canada safety and security standards and regulations.

10.26 The 1994 National Airports Policy. In addition to defining the National Airports System, the National Airports Policy clearly confirmed the government's intention to withdraw from the business of operating airports. It called for individual airports in the National Airports System to be self-sufficient within five years. The policy also called for Transport Canada to continue to own transferred NAS airports and to guarantee the integrity and long-term viability of the System. In addition, the policy directed that rent revenues from NAS airports would help fund capital requirements of airports outside the System.

10.27 Fundamental Principles for the Creation and Operation of Canadian Airport Authorities. The Fundamental Principles issued in 1994 for CAAs are virtually identical to the 1989 supplementary principles that apply to LAAs, with a few exceptions. Those deal largely with refinements to a number of the financial aspects of the supplementary principles, as elaborated in paragraph 10.28. The Fundamental Principles also updated the context of the transfer initiative by noting two key events that occurred after the 1989 supplementary principles were issued — the 1992 *Airport Transfer (Miscellaneous Matters) Act* and the National Airports System, established in the National Airports Policy of 1994.

10.28 Of the financial refinements made in the Fundamental Principles, perhaps the most notable was the requirement that financial terms negotiated with authorities "result in fair value for the federal government with appropriate consideration to the airports' future earning potential." In contrast, the 1989 supplementary principles explicitly require that the valuation of the airport to be transferred be on the basis of fair market value, with appropriate consideration to the airport's future earning potential. In our view, the requirement in the Fundamental Principles to get fair value in an airport's transfer does not preclude the need to determine, before the start of negotiations, the airport's value, on the basis of fair market value as a benchmark for analysis and decision making.

10.29 Public Accountability Principles. With the National Airports Policy, the government released a fourth set of principles — Public Accountability Principles — that transfers in the second round were to follow. These principles were meant to broaden the accountability of airport authorities. Among other things, they provided for the federal government to nominate (as opposed to appoint) two or three members to each airport authority's board of directors. The principles also cover conflict-of-interest requirements, community consultations and the general practice of obtaining competitive public tenders for contracts.

10.30 Other government directions from 1990 to 1998. Government directions such as approvals and decisions on individual transfer deals included some key refinements and exceptions to the transfer principles; they still apply today. For example, in December 1996 the government gave Transport Canada blanket authority to negotiate transfer deals for the remaining 16 airports without having to obtain specific approval for each one. In granting the blanket authority, it gave a number of directions on how Transport Canada was to apply the broad transfer principles issued previously. Many of the directions were very specific — indicating, for example, which components of the rent formula could be negotiated with airport authorities and which could not. Others allowed some exceptions to the transfer principles for the particular circumstances of specific deals. In granting the blanket authority, the government reiterated the requirement for Transport Canada to continue to ensure that all airport transfers reflect the principles of equity, consistency, uniformity, and fairness, one with the other.

The government directed Transport Canada to ensure that all airport transfers reflect the principles of equity, consistency, uniformity, and fairness, one with the other.

Transport Canada needs to formally codify its application of the transfer framework

10.31 We wanted to track for Parliament how Transport Canada had applied the 1987, 1989 and 1994 transfer principles, as well as the subsequent refinements and exceptions to them, as it negotiated and renegotiated each transfer deal. But we were unable to do so because of the problems discussed further below. Documenting how transfer principles are applied in the negotiation process is important; airport transfers have been ongoing for eight years, during which the government has issued hundreds of directions on them. We expected that Transport Canada would have a mechanism — a "codified framework" — to provide such a documented record over the long transfer process. A codified framework is not merely a set of principles and directions for negotiating transfers. Rather, it is an annotated trail or record that details how differences in the application of principles to specific transfer deals and renegotiations can be reconciled with, among other principles, "fairness, one with the other".

10.32 Such a codified framework would also document, for example, how certain key refinements or exceptions to transfer principles were applied in specific deals. This would include the blanket authority that in 1996 gave Transport Canada some flexibility to deviate from practices followed in previous deals on certain financial terms, and allowed the Department to negotiate on its own some elements of the formula that the government would otherwise have considered individually. According to the Department, some of these exceptions were necessary to reflect its role as guarantor of the viability of the National Airports System.

The loss of corporate memory in an environment where there is no codified "application" framework or roadmap is worrisome.

10.33 A codified framework would have tracked the way the Department applied the specific directions for each transfer deal in the context of the broad transfer principles — directions to, for example:

- provide financial support to some NAS airports beyond the original deadline of 31 March 2000 set by the National Airports Policy;
- provide a safety net by agreeing to renegotiate a lease after five years if the airport does not handle a minimum number of passengers each year; and
- reopen long-term lease agreements soon after transfer to provide financial support for capital projects at viable airports, under specific conditions.

We are concerned that the Department does not have such a framework of fundamental information that it ought to have. It would not only provide historical context but also, in our view, help ensure that a corporate memory survived over the 60-year period of the leases and could be drawn on for any future negotiations and renegotiations or any policy review.

10.34 Transport Canada has seen a significant turnover among the employees involved in airport transfers, as a result of changes in its mandate that occurred over the years as it was transferring the airports. The loss of corporate memory in an environment where there is no codified "application" framework or roadmap is, in our view, worrisome.

10.35 We note that while Transport Canada would be responsible for any policy review, given the large number of players involved in the National Airports System it would be important that the Department be able to provide other stakeholders with a clear picture of the current policy regime, against which any proposed policy changes could be assessed. A codified application framework would help to promote such a picture.

10.36 We think the absence of a formal, codified application framework also increases the risk of fragmented, inconsistent and disconnected decision making by the Department when negotiating and renegotiating transfer agreements. The section Managing and Administering Airport Transfers elaborates further (see paragraphs 10.58 to 10.106).

Transport Canada's five-year review still under way

10.37 In 1992, the Treasury Board directed the Department to carry out a comprehensive evaluation of transfers after five years, to determine their financial impact on the Department and to recommend an appropriate policy framework for future years. The Treasury Board reiterated that direction in 1997. Transport Canada planned the five-year review to focus only on the first round of transfers, those to the four local airport authorities. Although it was to have been completed in June 1998, the review exercise (which has cost almost $2 million) had not been finalized at the end of our audit in February 2000.

10.38 The preliminary results of the review have pointed to a number of concerns in the areas of transparency, airport charging principles (or user fees) and governance. The review has noted the need to make the management of airport authorities more transparent, accountable and consistent across the National Airports System. The review also noted some positive aspects of transfers, as elaborated in paragraphs 10.44 and 10.45. The Department believes that the review will help it adjust and improve policy to ensure that the government has the right policy instruments to protect the public interest.

10.39 At the end of our audit in February 2000, Transport Canada had yet to inform decision makers of any significant matter that may have surfaced during the review. During that time, Transport Canada continued to transfer NAS airports and had almost completed the second round at the end of our audit. Accordingly, any changes in the transfer agreements that the government may want to make as a result of the review may be more difficult and likely more costly, given that the large majority of transfer deals have already been negotiated. Any desired changes will have to be renegotiated with airport authorities, possibly at a cost to the Crown, as the renegotiations of three of the first-round transfers have shown.

10.40 During our audit, there was a considerable level of activity and effort by the Department to complete its five-year review. We understand that subsequent to our audit, the Department had compiled information and analysis and was summarizing its position and recommendations or courses of action for consideration by Treasury Board and/or Cabinet. This is intended for use in updating and formalizing the government's position on the National Airports Policy by the end of December 2000.

10.41 The Department had not finalized its position and recommendations from the five-year review at the conclusion of our audit. We did not examine the mandate or methodology used or audit the analyses undertaken by the Department as part of its review. However, we are encouraged by the increased interest in finalizing the review, as evidenced by the recent actions of the Department.

10.42 Transport Canada should codify into a comprehensive transfer application framework all exceptions and refinements made to transfer principles over time. It should include in the framework the way it applied the 1987, 1989 and/or 1994 transfer principles, as well as the exceptions and refinements, in each of the transfer deals. It should use that framework in completing the transfer of remaining airports in the National Airports System, in any policy review or evaluation of the results of the second round of transfers, and in any future renegotiations.

Department's response: *Transport Canada recognizes the benefits of having a comprehensive transfer application framework. The Department will consolidate its existing policies, decisions, guidelines and framework, and will continue to use it to guide future decisions and reviews.*

10.43 Transport Canada should, on an urgent basis, complete the five-year review first requested by the government in 1992 and report the results to decision makers and stakeholders.

Department's response: *As noted by the Office of the Auditor General, there was a considerable level of activity and effort by the Department at the time of the audit. The five-year review has been completed*

The preliminary results of the Department's five-year review have pointed to a number of concerns in the areas of transparency, airport charging principles (or user fees) and governance.

and the preliminary results were provided to decision makers in May 2000. The Department plans to seek direction from decision makers during Fall 2000.

The five-year review examined the airport divestitures policy; the performance of the local airport authorities; matters of public interest such as safety and security, financial viability, and governance; and assessed performance against the 1987 and 1989 principles along with the other major elements.

Financial and Operational Aspects of the National Airports System

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10.45 As a case in point, the Department cites the decision of the Edmonton Regional Airport Authority to transfer scheduled traffic from the Municipal Airport to the Edmonton International Airport. Another was the decision by Aéroports de Montréal to liberalize its operating policies so carriers could choose which airport would be used for international traffic; once they had that option, the carriers chose to relocate international traffic from Mirabel to Dorval.

10.46 According to Transport Canada, although some actions by airport authorities aroused significant local opposition, each authority believed that it was doing what was necessary to ensure the long-term viability of the airport, enhance its competitiveness and respond to the interests of the community at large. These had been factors in the government's rationale for transferring NAS airports in the first place. Another reason had been to trigger much-needed capital projects.

Capital works at transferred airports are impressive

10.47 Since the transfer process began in 1992, most of Canada's airports have undergone major physical improvements (see Exhibit 10.6). In deciding on the timing and nature of capital projects, levels of service and other areas, airport authorities have had a flexibility that was unavailable to Transport Canada (see Exhibit 10.5). As a result, they have been able to expand passenger facilities and

Exhibit 10.5

The Rationale for NAS Airport Transfers

The government's decision to get out of the airport business in the late 1980s was predicated on three realities.

First, only a few of the largest airports were operating at a profit or at least breaking even, and most airports had large and growing deficits, which represented a significant financial drain on the federal government.

Second, the significant funding to carry out much-needed expansions and upgrades to Canada's airports was not available, and undercapacity was becoming a problem. The government was not charging airport improvement fees.

Third, Transport Canada's approach to operating airports was national in focus, rather than local. Government ownership and control of airports thus meant that, in general, federal airports may not always have been operated in a way that reflected the specific economic needs and priorities of regions and local municipalities.

Transferring the management and operation of airports to airport authorities was intended to enable airports to operate as self-sustaining businesses that would contribute to developing local economies. This approach to operating airports was not always possible when the government managed them because various legal, policy and other constraints hindered its ability to both take advantage of the commercial potential of its airports and introduce efficiencies.

Source: Transport Canada

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First, only a few of the largest airports were operating at a profit or at least breaking even, and most airports had large and growing deficits, which represented a significant financial drain on the federal government.

Second, the significant funding to carry out much-needed expansions and upgrades to Canada's airports was not available, and undercapacity was becoming a problem. The government was not charging airport improvement fees.

Third, Transport Canada's approach to operating airports was national in focus, rather than local. Government ownership and control of airports thus meant that, in general, federal airports may not always have been operated in a way that reflected the specific economic needs and priorities of regions and local municipalities.

Transferring the management and operation of airports to airport authorities was intended to enable airports to operate as self-sustaining businesses that would contribute to developing local economies. This approach to operating airports was not always possible when the government managed them because various legal, policy and other constraints hindered its ability to both take advantage of the commercial potential of its airports and introduce efficiencies.

Source: Transport Canada

undertake various capital projects such as hotels, bridges, roads, parks and trails.

10.48 According to Transport Canada, these projects have benefited the regions and communities that the airports serve. The Department also noted that the timing and nature of the projects would have been significantly different had it continued to operate the airports. It informed us that reductions to operating and capital budgets for the past number of years would have resulted in deferring capital projects and extending the life of aging facilities and equipment.

10.49 Traditionally, sources of revenue for airports have included landing fees and revenues from concessions, land leases and development. Since the transfers, airport authorities have been able to raise their own financing through borrowing. This has enabled them to make significant capital improvements. They have also had an opportunity to recover costs by levying airport improvement fees, a tax-like fee, on travellers. Levying airport improvement fees is something the government has not done at the four NAS airports it still operates.

Changing conditions can affect airports financially

10.50 The ability to recover airport costs varies significantly from one airport to the next, depending on size. There are large differences in the number of passengers that airports handle (see Exhibit 10.7). Three airports, Calgary, Pearson and Vancouver, handle 62 percent of passenger traffic in the entire country; Pearson alone handles 33 percent. In 1998, Pearson ranked 24th in the world for aircraft movements and Vancouver was 31st.

10.51 Given the wide differences in passenger volumes, some airports can do better than others at sheltering themselves from potential losses of revenue when economic conditions and air traffic patterns change. Sensitivity to economic downturns and aviation industry restructuring is a key characteristic of the National Airports System, with implications for the financial viability of a number of airports.

Given the wide differences in passenger volumes, some airports can do better than others at sheltering themselves from potential losses of revenue when economic conditions and air traffic patterns change.

10.52 Current traffic at NAS airports is at an unprecedented peak, as Exhibit 10.8 shows. Since the first round of transfers in 1992, the airport industry has generally experienced a boom. Passenger traffic has

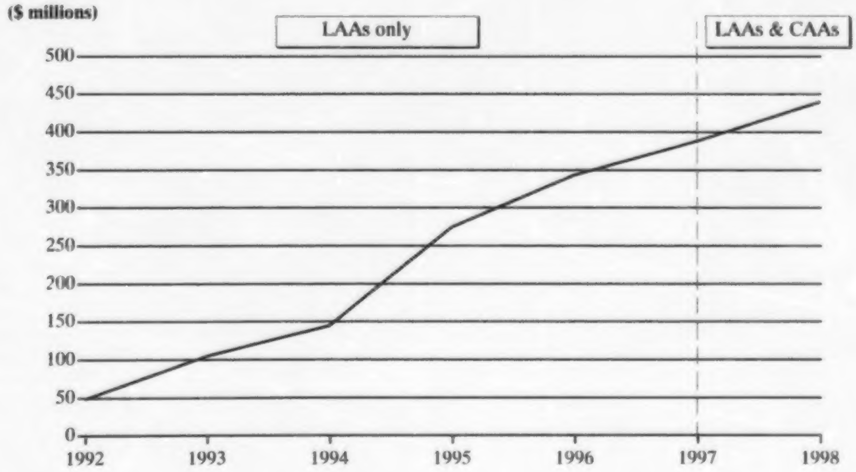


Exhibit 10.6

Capital Works at Eight Airport Authorities – From Date of Individual Transfers to 1998

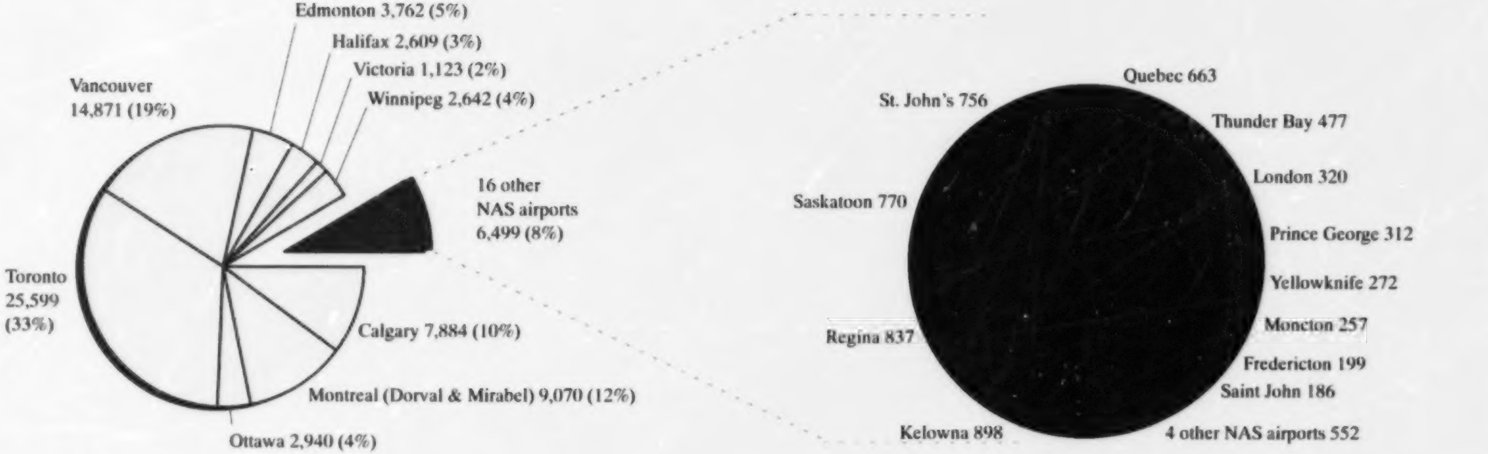
(current dollars)

Source: Annual report for each airport authority (current year cost of assets less prior year cost of assets)

Exhibit 10.7

1998 Passenger Traffic at NAS Airports

(in thousands)



Total traffic at 26 NAS airports, 1998
76,999 passengers

Source: Transport Canada

grown, and airport revenues with it. Airport authorities have consistently increased their revenues from a variety of sources. For many authorities, one of these sources is airport improvement fees. They accounted for about 22 percent of their combined airport revenues in 1998 (see Exhibits 10.9 and 10.10).

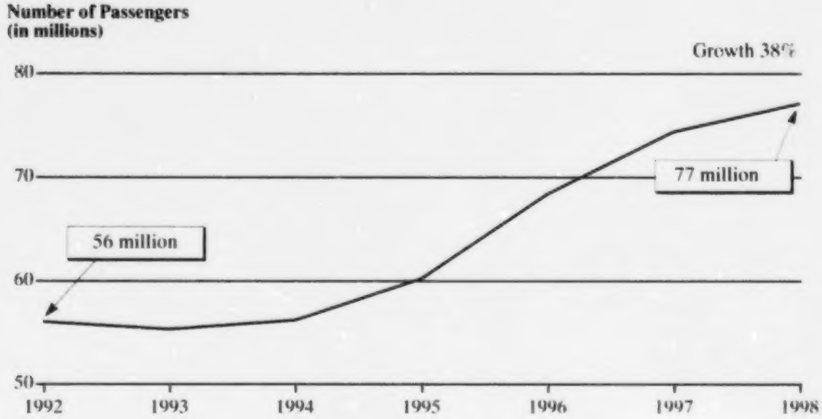
Government financial support continues after transfer

10.53 As early as the first round of transfers, it was intended that airport authorities would finance all of their operating and capital requirements "without recourse to the federal government" over the term of the lease. To the extent that there would be any government funding in the early years of transfer, its full recovery in subsequent years was expected. However, the government has made some exceptions. It indicated in the National Airports Policy of 1994 and in subsequent directions, for example, that it would give some financial support to smaller NAS airports for a few years, after which it would require all NAS airports to be self-sufficient. But there is no requirement in the policy that it recover the financial support provided in the early years. At the conclusion of our audit, the government had provided a cumulative total of $44 million in financial support to those smaller CAA airports.

10.54 As well, the original leases to LAAs provided for some $202 million in financial support by the government.

Exhibit 10.8

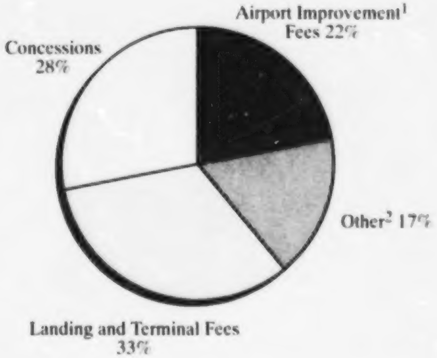
Passenger Traffic at 26 NAS Airports – 1992 to1998



Source: Transport Canada

Exhibit 10.9

Source of Revenues Collected by Airport Authorities in 1998



Notes: 1. Represents 22% of 1998 gross revenues for airports charging fees.

2. Includes revenues such as, but not limited to, leased lands and parking fees.

Source: Transport Canada

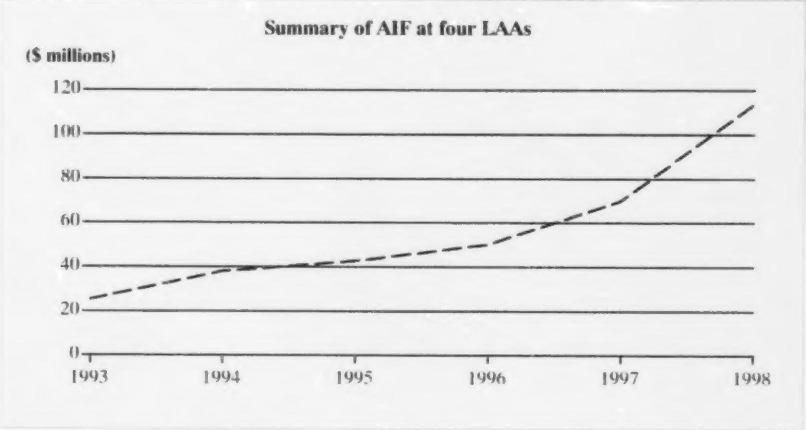
Exhibit 10.10

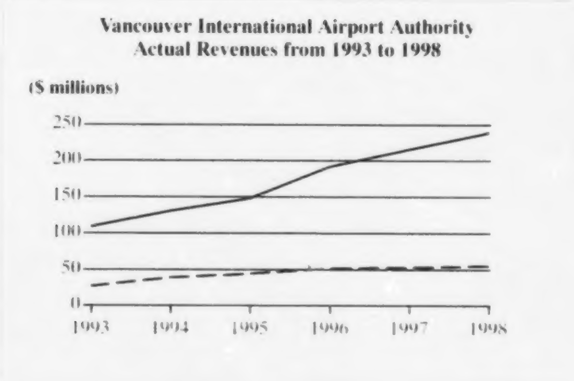
Comparison of Airport Improvement Fees and Actual Revenues for Local Airport Authorities – 1993 to 1998

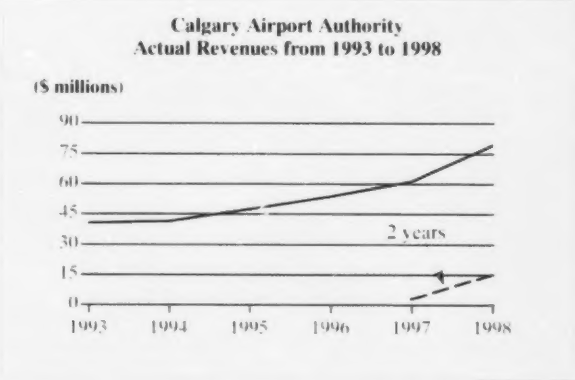
(current dollars)

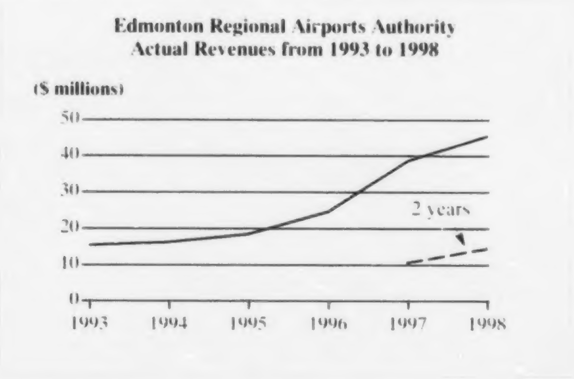
—— Total Revenues

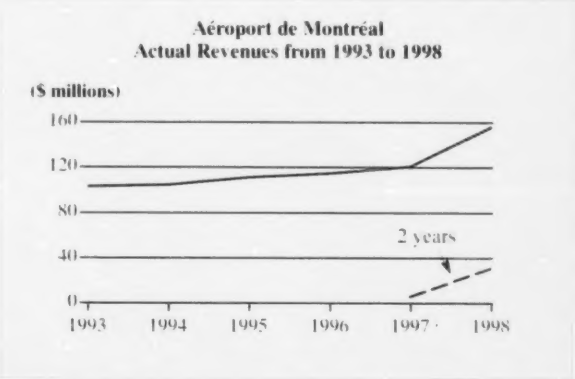
– – AIF


Summary of AIF at four LAAs


Vancouver International Airport Authority Actual Revenues from 1993 to 1998


Calgary Airport Authority Actual Revenues from 1993 to 1998


Edmonton Regional Airports Authority Actual Revenues from 1993 to 1998


Aéroport de Montréal Actual Revenues from 1993 to 1998

Note: Vancouver began collecting AIF in 1993; Calgary, Edmonton and Montreal began collecting AIF in 1997.

Source: Financial information in annual reports of the airport authorities

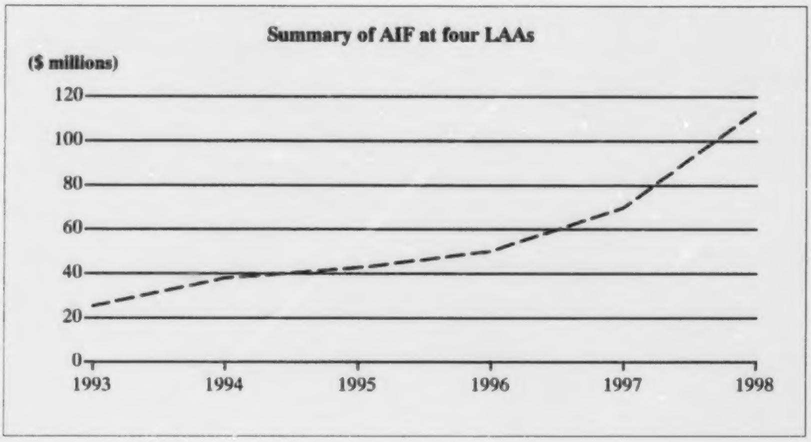
Exhibit 10.10

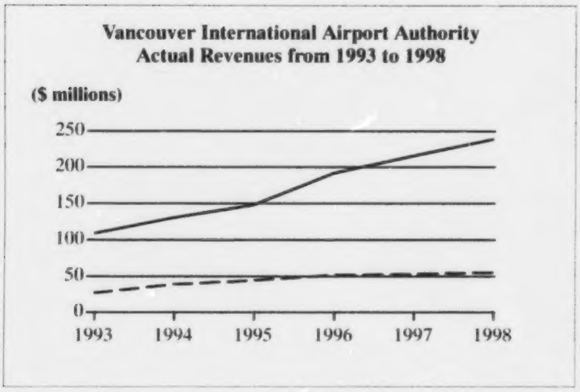
Comparison of Airport Improvement Fees and Actual Revenues for Local Airport Authorities – 1993 to 1998

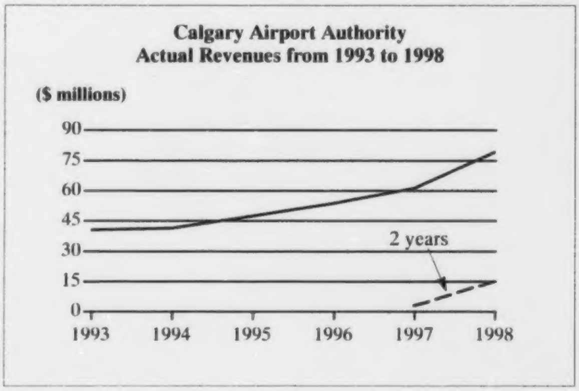
(current dollars)

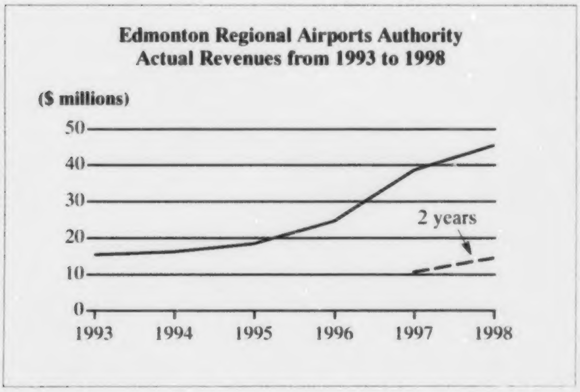
—— Total Revenues

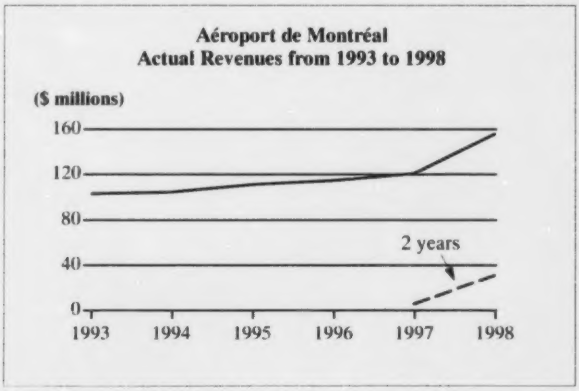
— — AIF











Note: Vancouver began collecting AIF in 1993; Calgary, Edmonton and Montreal began collecting AIF in 1997.

Source: Financial information in annual reports of the airport authorities under certain conditions. According to Transport Canada, the lease formula was designed in such a way as to lessen the burden on the airport authority in the short term but provide higher returns to the government in the long term. Including the $44 million in financial support to CAAs noted above, Transport Canada turned back or offset a total of some $246 million from 1992 to 1999 to fund shortfalls in LAA and CAA airport revenues (see Exhibit 10.11). It also agreed to defer to a future date about $44 million in rent, of which $30 million is still outstanding and will come due with interest starting on 1 January 2002.

10.55 In addition, the government agreed in 1997 and 1998 to renegotiate its transfer deals with LAAs in Edmonton, Calgary and Vancouver — three of the airports transferred in the first round — and with the CAA in Toronto (the first transfer in the second round). According to the Department, these renegotiations resulted in an estimated $474 million in forgone rent revenues ($342 million net present value) — that is, $210 million forgone by December 1999 and an estimated $264 million more in the next six to seven years. Under the renegotiated agreements with the LAAs, the government can nominate two or three members to each board of directors; this brings the structure of LAA boards into line with those of CAAs. In the Toronto renegotiations, the government agreed to give the Greater Toronto Airports Authority a rent credit toward a number of capital works projects at the Pearson Airport.

10.56 Transport Canada is not the only federal source of financial support for the operations of transferred airports. Some airport authorities have also received subsidies from the Atlantic Canada Opportunities Agency and the Canada Infrastructure Works Program, among others. Indeed, the federal government continues to provide significant financial support to transferred airports. Our analysis of Transport Canada's financial records (excluding the renegotiated deals with LAAs) reveals that from 1992 to 1999, the Department alone provided airport authorities with an average of about 37 cents in financial support for each dollar of total gross rent revenue (see Exhibits 10.11 and 10.12).

From 1992 to 1999, Transport Canada turned back or offset a total of some $246 million to fund shortfalls in revenues of transferred airports.

10.57 Three airports account for almost all of Transport Canada's revenue from rent. We found that three of the transferred airports — Calgary, Pearson and Vancouver — accounted for over 95 percent of Transport Canada's total revenues from rent in 1998, net of any financial support it provided that year. At four of the 10 other transferred airports, airport authorities paid no rent and, in fact, received net financial support from Transport Canada (Exhibit 10.13). Financial results for 1999 show a similar pattern — Calgary, Pearson and Vancouver were still the main revenue sources for the Department. In addition, the four that received net financial support in 1998 continued to do so in 1999, along with four more airports transferred that year (see Exhibit 10.11).

The Calgary, Pearson and Vancouver airports accounted for over 95 percent of Transport Canada's total revenues from rent in 1998.

Managing and Administering Airport Transfers

10.58 We examined Transport Canada's performance in managing and administering selected airport transfers — in particular, whether it had followed sound management practices and complied with government directions. We selected four second-round transfers to CAAs (Toronto, Ottawa, Moncton and Victoria) and four renegotiations (Edmonton, Vancouver, Calgary, and Toronto). We looked at Transport Canada's compliance with some of the government's key financial directions and principles for transfer. For LAAs, the principles included the requirement to determine the fair market value of the airports to be transferred. For CAAs there was a requirement that the financial terms for the airport transfer result in fair value

Exhibit 10.11

Airports Transferred to Airport Authorities –
Transport Canada Received Rent and Provided Support – 1992 to 1999 (current dollars)

Current Dollars (in thousands)	1992	1993	1994	1995	1996	1997	1998	1999	Total
Local Airport Authorities									
Aéroports de Montréal									
Gross rent revenue	7,576	20,028	18,945	21,119	23,563	20,045	22,839	23,598	157,713
Revenue shortfall	(9,044)	(23,727)	(23,543)	(19,951)	(21,566)	(21,327)	(22,311)	(21,040)	(162,509)
Negative rent*	(1,468)	(3,699)	(4,598)			(1,282)	-	-	(11,047)
Deferred rent	(2,500)	(6,000)	(6,000)	(6,000)	(6,000)	(3,500)	-	-	(30,000)
Vancouver International Airport Authority									
Gross rent revenue	19,759	27,726	36,695	41,390	47,664	51,933	57,081	59,728	341,976
(Deferred rent) / Reimbursed	-	-	(8,000)	-	8,000	-	-	-	0
Calgary Airport Authority									
Gross rent revenue	6,676	12,991	13,754	15,730	17,456	18,255	19,046	19,854	123,762
Revenue shortfall	(695)	(4,483)	(4,684)	(1,579)	-	-	-	-	(11,441)
Edmonton Regional Airports Authority									
Gross rent revenue	1,159	2,124	2,373	2,787	7	-	131	212	8,793
Revenue shortfall	(2,034)	(5,705)	(6,521)	(6,773)	(3,527)	(1,394)	(1,037)	(529)	(27,520)
Negative rent*	(875)	(3,581)	(4,148)	(3,986)	(3,520)	(1,394)	(906)	(317)	(18,727)
(Deferred rent) / Reimbursed	(625)	(1,429)	(1,503)	(2,254)	-	-	5,811	-	0
Canadian Airport Authorities									
Greater Toronto Airports Authority									
Gross rent revenue	-	-	-	-	1,522	106,033	108,460	117,902	333,917
Rent credit - Renegotiations	-	-	-	-	(1,522)	(103,485)	(12,621)	-	(117,628)
Ottawa Macdonald-Cartier International Airport Authority									
Gross rent revenue	-	-	-	-	-	3,977	5,282	5,967	15,226
Victoria Airport Authority									
Gross rent revenue	-	-	-	-	-	-	729	1,015	1,744
Negative rent*	-	-	-	-	-	(161)	-	-	(161)
Greater Moncton Airport Authority									
Negative rent*	-	-	-	-	-	(600)	(1,714)	(959)	(3,273)
Winnipeg Airport Authority									
Gross rent revenue	-	-	-	-	-	970	1,370	1,933	4,273
Thunder Bay International Airport Authority									
Negative rent*	-	-	-	-	-	(545)	(1,180)	(808)	(2,533)
Greater London International Airport Authority									
Negative rent*	-	-	-	-	-	-	(2,138)	(1,182)	(3,320)
St. John's International Airport Authority									
Negative rent*	-	-	-	-	-		(335)	(7,607)	(7,942)
Saskatoon Airport Authority									
Negative rent*	-	-	-	-	-	-	-	(9,652)	(9,652)
Charlottetown Airport Authority									
Negative rent*	-	-	-	-	-	-	-	(7,032)	(7,032)
Regina Airport Authority									
Negative rent*	-	-	-	-	-	-	-	(3,642)	(3,642)
Saint John Airport Inc.									
Negative rent*	-	-	-	-	-	-	-	(7,293)	(7,293)
SUMMARY									
Gross rent revenue	35,170	62,869	71,767	81,026	90,212	201,213	214,938	230,209	987,404
Less: Revenue shortfall supported by the Crown	(11,773)	(33,915)	(34,748)	(28,303)	(25,093)	(24,065)	(28,715)	(59,744)	(246,318)
Rent credit	-	-	-	-	(1,522)	(103,485)	(12,621)	-	(117,628)
Total federal support	(11,773)	(33,915)	(34,748)	(28,303)	(26,615)	(127,512)	(41,336)	(59,744)	(363,946)
Deferred rent repaid to (agreed by) the Crown	(3,125)	(7,429)	(15,503)	(8,254)	2,000	(3,500)	5,811	-	(30,000)
Net rent revenue received by the Crown	20,272	21,525	21,516	44,469	$65,597	70,201	179,413	170,465	593,458
Portion total federal support over gross rent revenue	33.5%	53.9%	48.4%	34.9%	29.5%	63.4%	19.2%	26.0%	36.9%

*Negative rent equals payments by Transport Canada to the airport authorities.
Source: Transport Canada

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Negative rent*	-	-	-	-	-	-	-	(9,652)	(9,652)
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***Negative rent equals payments by Transport Canada to the airport authorities.**
Source: Transport Canada

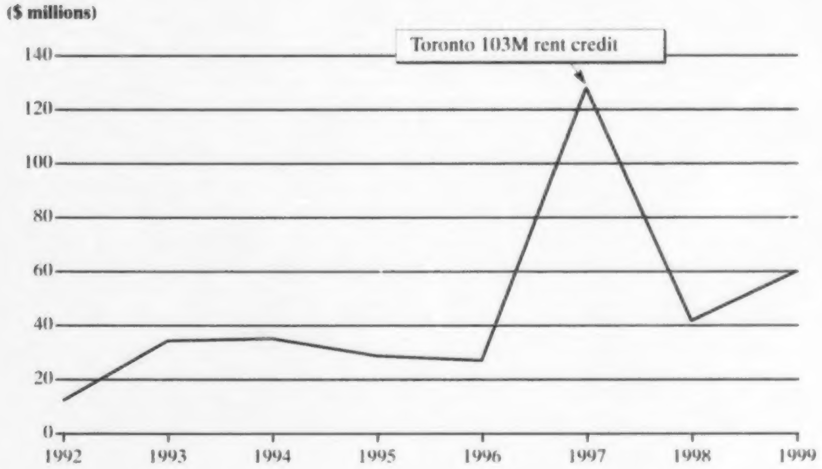


Exhibit 10.12

Federal Support* to Transferred Airports – Transport Canada 1992 to 1999

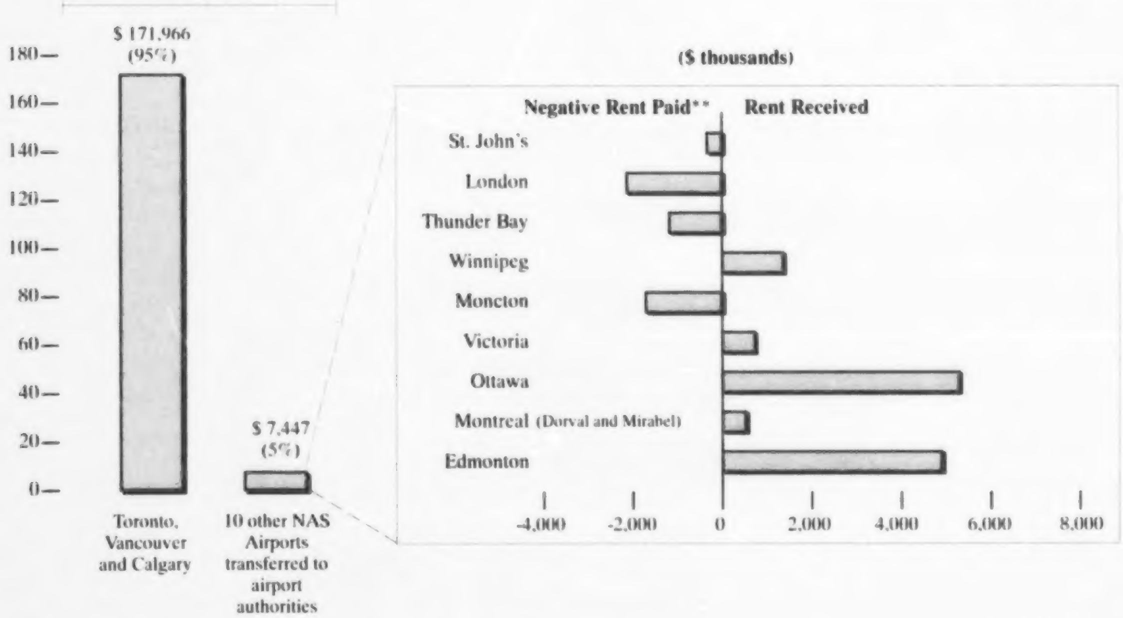
(current dollars)

* Represents either payments to authorities to offset or fund shortfalls in airport revenues and fund rental credits as per negotiated agreements.

Source: Transport Canada

Exhibit 10.13

Net Rent Revenue Received by Transport Canada in 1998 (including negative rent paid)


Three airports of the National Airports System accounted for 95% of the 1998 net rent revenue*
($ thousands)

* Net rent revenue = gross rent revenue less revenue shortfall, rent credit and deferred rent.

** Negative rent equals payments by Transport Canada to the airport authorities.

Source: Transport Canada

for the government, with appropriate consideration to the airport's earning potential. There was also a requirement for both LAAs and CAAs that the government be no worse off financially after transfers than before. We also reviewed the Department's adherence to the direction that all of the transfer deals, including renegotiations, reflect the principles of equity, consistency, uniformity and fairness, one with the other.

Transport Canada did not assess fair market value

We find it disturbing that Transport Canada decided not to determine the worth — the fair market value — of what it was transferring both before it entered into lease negotiations in the second round of airport transfers and before it began any renegotiations of existing leases.

10.59 We found that Transport Canada had not determined the worth — the fair market value — of what it was transferring before it entered into lease negotiations with airport authorities in the second round of transfers as well as the renegotiations of existing leases.

10.60 Transport Canada noted that in 1989, before entering negotiations on each of the four airports destined to be transferred in the first round (Montreal, Vancouver, Calgary and Edmonton), it engaged a financial advisor to determine their fair market value prior to negotiations, under various scenarios. The value computed in 1990 by the financial advisor under the lease option for Montreal was $453 million, for Vancouver $310 million, for Calgary $166 million and for Edmonton $56 million.

10.61 However, the Department informed us that it was made aware by its financial advisor that any valuation would be meaningful only after the transfer framework had been determined. According to the Department, this occurred only after the human resource and legal frameworks had been finalized. The Department further noted that the above-mentioned values computed for the four LAAs quickly became irrelevant as the asset packages that would be transferred took shape.

10.62 We note that some of the key elements of the entity to be transferred were clarified only in 1992, or later. Some of the clarifications are found in the *Airport Transfer (Miscellaneous Matters) Act,* such as the non-taxable status of airport authorities. Others are in the transfer arrangements negotiated with airport authorities, which, among other things, allowed airport authorities to levy user charges. Moreover, a decision was made not to regulate those charges.

10.63 We find it disturbing that Transport Canada decided not to determine the worth — the fair market value — of what it was transferring both before it entered into lease negotiations in the second round of airport transfers and before it began any renegotiations of existing leases — even though, by then, many of the previous limitations on determining the fair market value of airport business it was transferring were no longer present. Indeed, many unique elements of the entity to be transferred that were unknown in 1989 had been sufficiently defined by 1995 before the start of second-round transfers and any renegotiation, as evidenced by the transfer deals and supporting policy statements and legislative framework. The Department's position is that the conditions and circumstances that served as the basis for the advice from the Department's independent financial consultants for the first round transfers continued to exist for the second round transfers and renegotiations. For the reasons cited above, we do not consider the Department's position persuasive.

10.64 Moreover, the valuation of the airports still to be transferred could also draw on the operational and financial performance of those already transferred for such things as growth potential, profitability, and ability to raise financing and levy user charges. In our view, the Department's failure to obtain an independent determination of fair market value of the airports once the elements of transfer had been clearly defined, and once markets for funding airport operations had been proved, represents a clear departure from sound management practice.

10.65 Transport Canada believes that it ended up getting a fair value through the negotiations and renegotiations. The Department notes that it provided the Minister, Treasury Board and/or Cabinet with a range of values in support of each transfer deal. However, this range of values deals specifically with a floor position so that the government can assess whether it would be no worse off (see paragraphs 10.76 and 10.77). The floor position does not represent a full range of possible values for fair return. Moreover, because the Department was negotiating each deal with only one party and outside a normal competitive environment, it could not inform decision makers how the offers made by airport authorities in the second round of transfers and any proposals for reduced rent would compare against a reasonable range of fair market value.

10.66 Transport Canada used the net book value of the airport assets at the time of transfer to establish a key element of the LAA formula. We further note that the net book value was also used as the benchmark for fair market value by Transport Canada when it requested approval from Treasury Board for the renegotiating of the rent at Vancouver, Edmonton and Calgary. Generally, book value is significantly different from fair market value. Unlike fair market value, book value does not reflect the real worth of a going concern with the potential to generate substantial revenue — rather, it is more a function of historical costs. (For example, in 1989 the valuation of the Montreal airport was placed at three times that of the Calgary airport. This occurred because the net book value of Montreal included two airports — Dorval and Mirabel — to be "cost recovered" from users, while Calgary had only one. The Lester B. Pearson International Airport is another example. According to the Department, prior to its negotiating the transfer in 1995 the fair value of the Pearson airport's airside and general terminal business would have been minimal, because the assets were almost fully amortized.)

10.67 Accordingly, using a return on the net book value as the sole benchmark is unlikely to provide a meaningful basis for assessing the fairness of rent. It is noteworthy that in its 1997 Fourth Report to the House of Commons, the Public Accounts Committee made a number of recommendations on the transfer of the air navigation system to a not-for-profit corporation. Among them was that for any planned divestiture, the government obtain formal valuations from independent advisors and that it do so after the nature and the value of the assets to be transferred had been clearly defined, and also that it use these valuations as a benchmark before the start of any negotiations.

Unlike fair market value, book value does not reflect the real worth of a going concern with the potential to generate substantial revenue.

10.68 **Fair market value information relevant for decision making.** In our view, before it started negotiating each transfer and before renegotiating existing airport deals, the Department ought to have determined a range of fair market value for each airport. In assessing the fair market value of an entity that is a going concern, has no share capital and finances itself entirely through debt, it is important to apply a test of "financeability" (see Exhibit 10.14). Financeability is a measure of the amount that investors

Exhibit 10.14

Definition of Financeability

In assessing an entity's going-concern value, it is important to have the value tested in the financial markets. In this case, because the corporation was intended to be financed entirely through debt, the test of that market was to help determine the amounts investors were willing to risk in the venture. This test of the market, known as assessing the financeability of the entity, provides an additional indication of whether the assessed value is reasonable.

Source: Auditor General's October 1997 Report, Chapter 19, Transport Canada – The Commercialization of the Air Navigation System.

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would be willing to risk in a business, and it is a good and practical indicator of fair market value. As such, financeability is an integral component of discounted cash flow methodology when determining the net present value of business worth.

10.69 The lack of information on fair market value in the business cases supporting the transfers has, in our view, two serious implications. First, it means that the Minister, Treasury Board and/or Cabinet were not given all the relevant facts — that is, a full range of the possible value of each airport to be transferred. Second, they were not given an appropriate benchmark against which to assess whether, for example, the rent amounts they were being asked to approve were fair and reasonable.

The lack of information on fair market value in the business cases supporting the transfers has serious implications.

10.70 It is noteworthy that, still without having obtained essential information on their business worth, Transport Canada subsequently renegotiated rent reductions totalling an estimated $289 million for three of the four NAS airports it had transferred in the first round.

10.71 After the renegotiations and as part of its five-year review of the first round of transfers, Transport Canada analyzed the fairness of the rents charged to the four LAAs. Looking at the Crown's rate of return and using a very conservative approach, the analysis showed that the rent at all four airports as and where renegotiated was well below market value, and there was no evidence that the authorities could not have afforded the original rent. The Department has yet to undertake a similar study of the airports transferred in the second round.

10.72 Before entering into negotiations or renegotiations of airport transfer agreements, the government should obtain a formal valuation opinion from a qualified independent professional on the fair market value of what it is transferring and use that information to assess and develop a position on a fair rental charge.

Department's response: *See response following paragraph 10.106.*

Is the government better off?

10.73 In 1992, the government explicitly directed that Transport Canada ensure that it would be "no worse off" as a result of transferring the airports, from two perspectives. First, the government's financial position was to be no worse off overall after transfer than before, taking into account all of its responsibilities for all airports combined. This position would be measured on the basis of a net present value of the impact on the government's fiscal framework and the Department's reference levels (its budget). Second, the government was to be "no worse off" at each airport and, indeed, was to be better off financially over the term of the lease than if Transport Canada had continued to operate the airport. According to Transport Canada, being "no worse off" in this respect is a critical criterion in determining whether the government ought to proceed with a particular transfer proposal. (Exhibit 10.15 discusses the concept of "no worse off".)

10.74 No worse off overall. In reference to "no worse off" from the first perspective, we wanted to review any analysis done by Transport Canada to assess whether the government was no worse off overall. We found that Transport Canada has yet to determine and update

Exhibit 10.15

Definition of "No Worse Off"

> **"'No worse off' means that the net present value of the lease payments over the first 20 years of the lease must be equivalent to or higher than the net present value of the projected cash flow of the airport had Transport Canada continued to manage and operate it." (No worse off position for individual airports.)**
>
> **"The government's financial position after transfer was to be no worse than before the transfer, measured on the basis of a net present value of impact on the fiscal framework." (No worse off position overall.)**

Source: Transport Canada

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Source: Transport Canada

with each transfer how airport transfers have cumulatively affected the government's fiscal framework. Nor has it updated its estimate of how the airport divestitures have affected its own budget (reference levels) on a cumulative basis since 1996.

Transport Canada has yet to determine and update how airport transfers have cumulatively affected the government's fiscal framework and, on a cumulative basis since 1996, its own budget.

10.75 Such an exercise would serve as a check to help ensure that federal funding for airports would not increase in the long term as a result of the transfers. Because these transfers have happened one at a time, timely analysis to assess whether the government is no worse off overall would have provided decision makers with a useful scorecard, in our view. It would have shown, for example, how transfers were affecting on a cumulative basis the government's and the Department's cash flow and overall financial position over the term of the leases. This information would have contributed to a full set of relevant facts for decision makers as they considered and decided on new transfer proposals and any renegotiations. We think Transport Canada ought to be providing Parliament with such information in its accountability reporting.

10.76 Ensuring that the government is no worse off with each airport transfer. In assessing airport authorities' offers in the second round of transfers to ensure that the government would be no worse off, we note that the Department changed key parameters for assessing whether the government would be no worse off as a result of transfers; further, we note that these have changed over time. For example, for LAA airport transfers the Department used a compensatory pricing policy (or full-cost-recovery assumption — that is, no provision was made for future expansion, major improvements or commercial projects because they were to be funded entirely from new revenue sources and not from departmental appropriations). But in the Pearson transfer, the first CAA airport, the Department assumed that it would have to fund a significant portion of capital works for future expansion — and that the funds would come from the airport's revenues. As a result of its analysis, Transport Canada presented a business case to the Treasury Board showing that the government would be better off by $271 million to $829 million as a result of the Pearson transfer. The compensatory pricing assumption it had used in all previous transfers would have shown significantly different results. It would have left the government significantly "less better off" — if not worse off — and potentially by a few hundred million dollars. The Department developed two floor positions at around the same time, one with an express assumption that it would fund capital works and the other without. The difference between the floor positions was substantial, a difference ranging from more than $621 million to more than one billion dollars over the term of the lease. In its five-year review a few years later, to measure the governments financial position after the transfer of the four LAAs the Department reverted to its previous assumption, a compensatory pricing policy. It noted that the compensatory pricing policy was not an assumption used in any of the transfers to CAAs.

In assessing whether the government's position was no worse off with each airport transfer, the Department changed key parameters. The implications of the changes were never fully assessed for fairness and equity, or properly documented.

10.77 In addition to assuming compensatory pricing, the Department informed us that it had changed other assumptions and parameters for assessing whether the government would be no worse off with individual transfers. These changes were made to take into account changes in economic policy, economic conditions, administrative policy and government directions during the eight years over which transfers occurred. The implications of these changes for its floor position in previously negotiated deals, and for renegotiations, were never fully assessed for fairness and equity or properly documented. Nor were the change in assumptions and parameters and the rationale for those changes clearly made known to the Minister, the Treasury

Board and the Cabinet as each new transfer proposal went forward. We consider that not providing decision makers with this contextual continuum was a serious weakness in the transfer process. We are concerned that it may have resulted in less favourable terms and conditions in some leases than in others.

We find it extraordinary that the Department would agree to an arrangement that would leave it without access to some essential information on which its consultant's analysis and conclusions were based.

10.78 For each of the four CAA transferred airports in our sample, we asked Transport Canada for its analysis of whether the government would be no worse off over the term of the lease (that is, its floor position) at the end of negotiations. We reviewed the available documentation but found that the methodology used was highly conceptual and based on historical, unaudited data. It was also replete with judgments and assumptions about what the Department would have done in the future (typically 18 to 20 years) in areas such as capital investments and operations, had it continued to operate the airports. The floor position was what one of Transport Canada's financial advisors called a "best guess" estimate. Given the highly hypothetical scenarios and methodology used to arrive at the floor position, we can provide no assurance as to whether the government was better off or worse off at the time of transfer. Moreover, we consider that a methodology based on many significant ex post facto (after-the-fact) assumptions of what Transport Canada might have done had it stayed in the airport business is inappropriate for determining its position at any given time after transfer. Such a determination will grow more difficult and abstract over time; and Transport Canada is already almost completely out of airport operations.

10.79 In 1999, a consultant hired by the Department completed an after-the-fact analysis of the government's financial position with individual transfers to the four local airport authorities in the first round, to determine whether it is no worse off after transfer. The Department does not have much of the key documentation gathered by its consultants to support their analysis. It informed us that this was the result of a decision to maintain the confidentiality of the information that airport authorities provided to the Department's consultants.

10.80 We find it extraordinary that the Department would agree to any such arrangement that would leave it lacking access to information essential to understanding the basis and context for its consultant's analysis and conclusions — conclusions that could form the basis for the Department's recommendations to the Treasury Board and Cabinet. We note that under the transfer arrangements, the Department already had a general right to such information. The Department's new arrangement vis-à-vis the consultants' analysis and conclusions meant that Transport Canada did not have, for example, even the list and copies of consultants' reports and documents that the consultants had relied on in preparing the analysis. Key notes or transcripts of fact-finding interviews with airport authorities, airlines, the financial community and other federal departments were unavailable. We note that the Department could not provide us with documentation showing the evidence used to support key assumptions and projections in areas such as pricing, cost recovery and capital expenditures. Nor could it provide us with the computer files containing the modelling runs used to determine its financial position as a result of the first round of transfers.

10.81 We therefore are unable to verify and provide any assurance on the results of the analysis. That said, the analysis found that over the first five years after the transfers, the government was better off at one airport, marginally worse off at another, neutral with respect to a third airport (neither better off nor worse off) and significantly worse off at the fourth airport. Although the analysis had been completed — as part of three separate studies with a total cost of $680,000 — roughly a year before our audit ended in February 2000, we found that decision makers, including Treasury Board, had not yet seen the results.

10.82 Transport Canada has yet to conduct any such analysis of the other NAS airports in our sample (Toronto, Ottawa, Moncton and Victoria).

Transport Canada has not analyzed the overall financial impact of the airport transfers

10.83 In our view, the Department needs to develop a credible way to measure the overall financial impact of the airport transfers after transfer, in terms of benefits and costs. Its evaluation of the first round of NAS airport transfers has been under way for the past three years and has used many financial advisors. It is therefore disconcerting that Transport Canada has yet to establish a proper framework to evaluate and report on the overall financial impact of the airport transfers at any time after transfer over the life of the 60-year leases.

10.84 Transport Canada should periodically gather information on fair market value to use in assessing the appropriateness of the rents it has already negotiated, developing a reasonable benchmark, and evaluating any proposals from airport authorities to renegotiate their existing leases. It should use the results of such work to form the basis of new renegotiation proposals.

10.85 Before negotiating or renegotiating airport transfers, Transport Canada should establish a minimum amount as a floor position for assessing whether authorities' offers will leave the government no worse off. It should properly document all assumptions used in determining its floor position and any changes to them over time, and should clearly communicate them to decision makers when seeking their approval for the transfer agreements or any renegotiated agreements.

Department's response: *See response after paragraph 10.106.*

10.86 When using external consultants to perform financial analyses related to airport transfers, Transport Canada should maintain appropriate documentation and records.

Department's response: *Transport Canada will continue to maintain appropriate documentation and records, when using external consultants.*

10.87 Transport Canada should develop an alternative to its current no-worse-off analysis to measure the overall financial impact of airport transfers at any time after transfer over the life of the 60-year leases, and report the results to decision makers and to Parliament on a timely basis.

Department's response: *See response after paragraph 10.106.*

It is disconcerting that Transport Canada has yet to establish a proper framework to evaluate and report on the overall financial impact of the airport transfers at any time after transfer over the life of the 60-year leases.

Quality of information to decision makers needs significant improvement

10.88 Transport Canada is not allowed to negotiate any amendments to the LAA leases that affect financial arrangements without first obtaining approval from the Treasury Board. Our review of the Department's analysis to support the renegotiations of the leases at Vancouver, Calgary and Edmonton left us with significant concerns about the quality of information it provided to the Treasury Board.

10.89 Renegotiations. When it issued the National Airports Policy in 1994, the government announced that the second round of transfers to Canadian airport authorities (the CAAs) would use a new standard formula to calculate rents (see

Exhibits 10.16a and 10.16b). Both the rent formula and the accountability principles to be applied were different from those applied in the first round of transfers to the LAAs. The Minister agreed to reopen those deals for negotiation in light of the new National Airports Policy and Public Accountability Principles. In 1995, Transport Canada began renegotiating the financial terms of the leases for three of the four LAA airports (Vancouver, Calgary and Edmonton) transferred in 1992.

10.90 In 1995, Transport Canada engaged a financial advisor to assess the financial implications of the new rent formula for LAA deals, before it was used in transferring the remaining airports to Canadian airport authorities. Although we did not audit that assessment, we believe it was an important exercise to provide a perspective on the fairness of the new CAA rent formula compared with the formula originally used for LAAs. Later in 1995, when Transport Canada began renegotiating with the LAAs at Vancouver, Calgary and Edmonton, it knew its financial advisor's view that applying the new formula to these local airport authorities would have minimal financial implications for them. Although we understand that reopening the first round of transfer deals could have some financial impact, we expected that

Exhibit 10.16a

Overview of the Lease Rental Formula – Local Airport Authorities (LAAs)

LAA

	Business Components	Base Revenues	-	Base Costs	=	Base Rent
BASE RENT	Airside/General Terminal (AGT)	Stated landing fees from airlines	-	Stated costs of operating the airport	=	Base AGT
	Concessions	Rental fees from boutiques	-	Stated costs of maintaining the rental spaces	=	Concession base rent
	Real estate (Base rent)	Rental fees from existing land leases at date of transfer	-	Not applicable	=	Real estate base rent

+

	Business Components	Actual Revenues	-	Stated Revenues		Applicable Participation Percentage	=	Participation Rent
PARTICIPATION RENT	Airside/General Terminal (AGT)	Actual landing fees from airlines	-	Threshold landing fees from airlines	X	Rate varies from 8% to 25% Applicable rate	=	AGT participation rent
	Concessions	Actual rental fees from boutiques	-	States rental fees from boutiques			=	Concession participation rent
	Airport Improvement Fees (AIF)	Actual AIF revenues	-	Not applicable			=	AIF rent
	Real estate (Participation rent)	Rent based on fair market value	-	Not applicable			=	Real estate participation rent
	Other	Actual other revenues	-	Not applicable			=	Other revenues rent

Source: Transport Canada

Transport Canada would have valued each element it was renegotiating, measured the impact for fairness and equity with deals negotiated in the second round (the transfers to CAAs), and presented that information to Treasury Board and Cabinet. The renegotiated deals effectively reduced the revenue stream or rent payable to the Department by an estimated $289 million total over the term of the three leases, with no clear indication, in our view, as to what benefits the Crown would receive from the substantial rent reductions that were renegotiated. The Department informed us that the benefits were "to relieve the following pressures that were driving renegotiations:

- accelerated growth and passenger traffic;
- consequential pressure to accelerate capital expansion;
- the perceived superiority of the CAA rent model; and
- a desire to install the Public Accountability Principles."

The Department also indicated that it wanted to rectify an inequity between the LAA models and the CAA models with respect to charging rent on the AIF (airport improvement fee).

10.91 We note that one of the five benefits the Department had cited to us, the perceived superiority of the CAA rent model, was not made known to the Treasury Board and Cabinet. Moreover, the Department did not eliminate the inequities in the rent formula. In fact, the renegotiations created new inequities (see paragraph 10.95).

Exhibit 10.16b

Overview of the Lease Rental Formula – Canadian Airport Authorities (CAAs)

CAA Formula

	Base Revenues	-	**Base Costs**	=	**Base Rent**
BASE RENT	Stated $ amount per passenger multiplied by the actual number of passengers up to a cap level adjusted for CPI*	-	Stated base costs adjusted for CPI	=	Base rent

+

	Actual Revenues	-	**Base Revenues**		**Applicable Participation Percentage**	=	**Participation Rent**
PARTICIPATION RENT	Actual gross revenues	-	Stated $ amount per passenger multiplied by the actual number of passengers up to a cap level adjusted for CPI	X	Rate varies from 0% to 35% Applicable rate	=	Participation rent

Note: Overall rent could be negative in years prior to self-sufficiency.

* Consumer Price Index

Source: Transport Canada

Exhibits 10.16a and 10.16b). Both the rent formula and the accountability principles to be applied were different from those applied in the first round of transfers to the LAAs. The Minister agreed to reopen those deals for negotiation in light of the new National Airports Policy and Public Accountability Principles. In 1995, Transport Canada began renegotiating the financial terms of the leases for three of the four LAA airports (Vancouver, Calgary and Edmonton) transferred in 1992.

10.90 In 1995, Transport Canada engaged a financial advisor to assess the financial implications of the new rent formula for LAA deals, before it was used in transferring the remaining airports to Canadian airport authorities. Although we did not audit that assessment, we believe it was an important exercise to provide a perspective on the fairness of the new CAA rent formula compared with the formula originally used for LAAs. Later in 1995, when Transport Canada began renegotiating with the LAAs at Vancouver, Calgary and Edmonton, it knew its financial advisor's view that applying the new formula to these local airport authorities would have minimal financial implications for them. Although we understand that reopening the first round of transfer deals could have some financial impact, we expected that

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Overview of the Lease Rental Formula – Local Airport Authorities (LAAs)

LAA

	Business Components	**Base Revenues**	-	**Base Costs**	=	**Base Rent**
BASE RENT	Airside General Terminal (AGT)	Stated landing fees from airlines	-	Stated costs of operating the airport	=	Base AGT
	Concessions	Rental fees from boutiques	-	Stated costs of maintaining the rental spaces	=	Concession base rent
	Real estate (Base rent)	Rental fees from existing land leases at date of transfer	-	Not applicable	=	Real estate base rent

+

	Business Components	**Actual Revenues**	-	**Stated Revenues**		**Applicable Participation Percentage**	=	**Participation Rent**
PARTICIPATION RENT	Airside General Terminal (AGT)	Actual landing fees from airlines	-	Threshold landing fees from airlines		Rate varies from 8% to 25%	=	AGT participation rent
	Concessions	Actual rental fees from boutiques	-	States rental fees from boutiques	X	Applicable rate	=	Concession participation rent
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- accelerated growth and passenger traffic;
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Exhibit 10.16b

Overview of the Lease Rental Formula – Canadian Airport Authorities (CAAs)

CAA Formula

	Base Revenues	-	Base Costs	=	Base Rent
BASE RENT	Stated $ amount per passenger multiplied by the actual number of passengers up to a cap level adjusted for CPI*	-	Stated base costs adjusted for CPI	=	Base rent

+

	Actual Revenues	-	Base Revenues		Applicable Participation Percentage	=	Participation Rent
PARTICIPATION RENT	Actual gross revenues	-	Stated $ amount per passenger multiplied by the actual number of passengers up to a cap level adjusted for CPI	X	Rate varies from 0% to 35% Applicable rate	=	Participation rent

Note: Overall rent could be negative in years prior to self-sufficiency.

* Consumer Price Index

Source: Transport Canada

10.92 Information provided to the Treasury Board and Cabinet was inaccurate and incomplete. In December 1996, while renegotiations were under way, Transport Canada informed the Treasury Board that the LAAs at Calgary and Edmonton would adopt the new rent formula in full, and that Vancouver would adopt it in part. The Department also said that the revised rents would not materially affect its budget; it projected a $7.5 million reduction in its budget over the first four years covered by the renegotiated agreements. But this did not represent the full costs of the renegotiations. Only later, when the Treasury Board Secretariat requested a business case to support the renegotiations, did the Department estimate that the rent reductions in the renegotiated deals would cost over $124 million in the first five years. In February 1997, Treasury Board approved the amendments to the leases on the basis that the three airports had agreed to adopt the Public Accountability Principles. Renegotiations with airport authorities continued, and amended agreements were signed with Calgary in April 1997, Edmonton in December 1997 and Vancouver in June 1998.

A key weakness in the renegotiation process was the absence of any independent review and challenge of the final agreements before they were signed. In fact, the deals were significantly different from what Treasury Board had authorized.

10.93 A key weakness in the renegotiation process was the absence of any independent review and challenge of the final agreements before they were signed. In fact, the deals were significantly different from what the Treasury Board had authorized. We note that at the time the deals were finalized, Transport Canada did not advise the Treasury Board that in the final renegotiated agreements not one of the airports agreed to fully adopt the Public Accountability Principles, nor did it provide the reasons for their stance. These principles are central to ensuring a consistent accountability framework for all airports and the protection of the government's and taxpayers' interests. As illustrated in Exhibit 10.17, the renegotiated deals excluded certain key aspects of the Public Accountability Principles, such as equitable access by all carriers, reasonable user charges, activities consistent with the airport authority purpose, the general practice of tendering contracts, and declarations of business activities to avoid real or perceived conflicts of interest. In our view, the Department ought to have informed Treasury Board and/or Cabinet of the concerns expressed by airport authorities that did not accept those Public Accountability Principles. For example, some airport authorities did not accept the principles relating to reasonable user charges and equitable access to all air carriers because, according to Transport Canada's records, they feared that including the principles in their letters patent could expose them to litigation on the reasonableness of the charges and equity of access. We believe that this kind of omission significantly impaired the quality of information made available to decision makers when they approved the renegotiations.

10.94 The fairness issue. One of the principles to guide the transfer of airports to CAAs was that all financial arrangements were to reflect the principles of equity, consistency, uniformity and fairness, one with the other. We acknowledge that certain differences exist among airports and that any financial arrangements must take these differences into account.

10.95 However, we were surprised to find that after renegotiation, the final agreements treated comparable airports differently (see Exhibit 10.18). For example, only Calgary's renegotiated lease included, in effect, a ceiling on its total rent (base rent and participation rent) for 10 years — Transport Canada having agreed to a passenger cap below the actual number of passengers at the time of renegotiations and having eliminated the clause requiring the payment of participation rent (see Exhibit 10.19). The renegotiated lease with Edmonton also includes a clause unique to that airport, with a provision retroactive to 1996 extending forward 10 years to 2006. Under that clause, Transport Canada will continue to pay negative rent to fund shortfalls in airport revenues. Since 1996 the Department has paid $6.4 million to the airport authority for this purpose. The clause also provides for a significantly higher subsidy to the Edmonton airport authority in the event of a downturn in the economy.

10.96 As a result of these renegotiations, Transport Canada has actually created three different rent formulas under essentially one model for CAAs. When we add the standard CAA formula for second-round transfers and the original LAA formula that still applies to Montreal, the Department is really administering five different rent formulas.

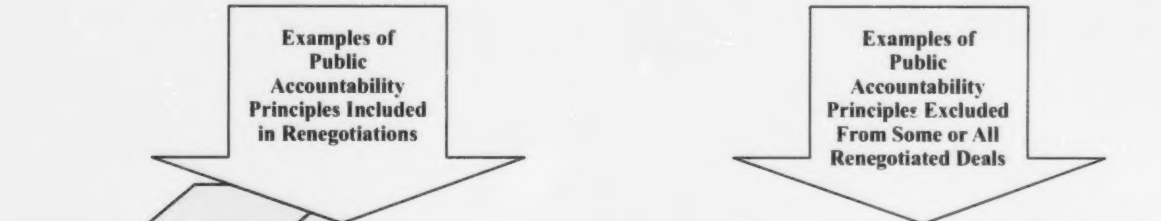
10.97 Transport Canada has not been able to demonstrate how transfer agreements as and where renegotiated based on different formulas can be equitable, uniform, consistent and fair, one with the other.

10.98 We were informed that the team that had negotiated the original LAA deals did not handle the renegotiations. It was the view of the Department that the lease renegotiations would be more appropriately handled by those officials who were responsible for lease management. We note that key financial elements/principles underlying the first

Transport Canada has not been able to demonstrate how transfer agreements as and where renegotiated based on different formulas can be equitable, uniform, consistent and fair, one with the other.

Exhibit 10.17

Examples of Public Accountability Principles Included/Excluded in Renegotiated First-Round Transfers


Examples of Public Accountability Principles Included in Renegotiations
Safe, secure and financially viable
Not-for-profit corporation
Transport Canada right to audit
Five year performance review
Develop lands compatible with air transport activities
Board of Directors includes two or three federal nominees
Code no less stringent than *Canada Business Corporation Act*
Examples of Public Accountability Principles Excluded From Some or All Renegotiated Deals
Reasonable user charges
General practice of tendering contracts
Equitable access to all carriers
Declaration of business activities to avoid real or perceived conflict of interest
Engage in activities consistent with purpose

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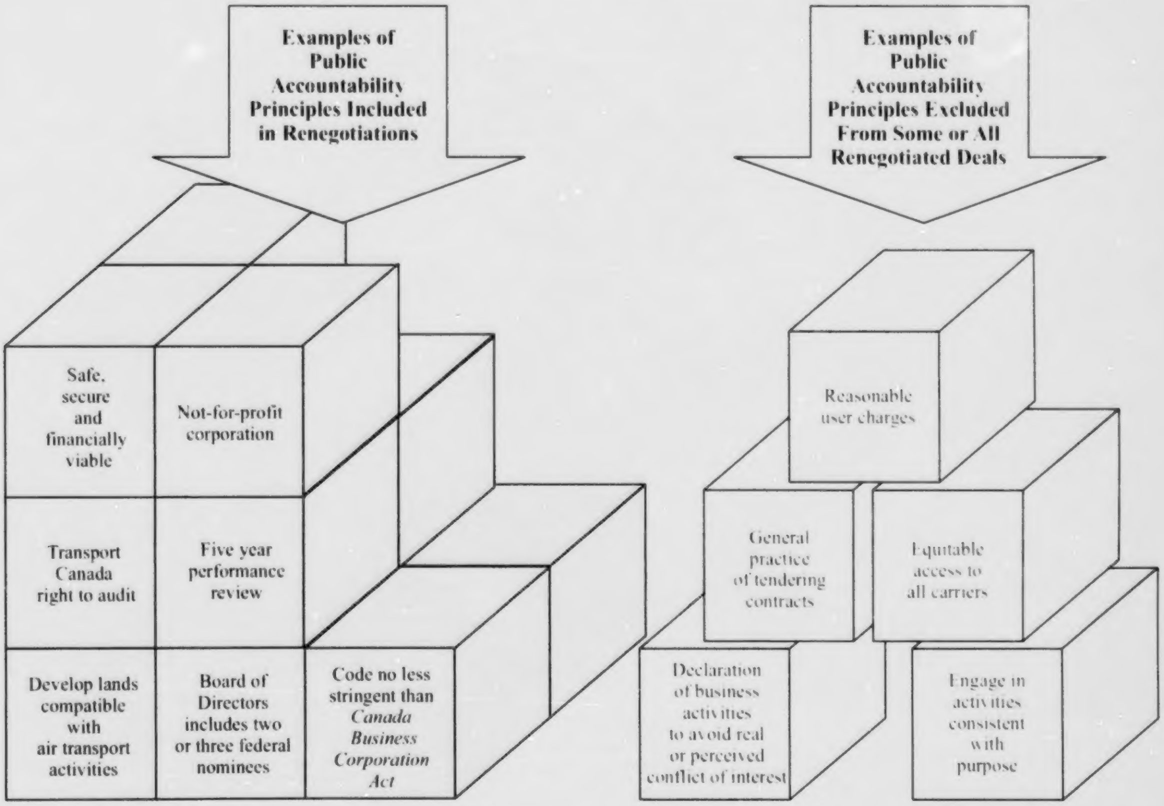
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and second rounds of transfers were not applied consistently in the renegotiations. In fact, while the deals were being renegotiated, the Department's chief negotiator (who had negotiated the original LAA deals and the first few CAA deals) had some concerns about the amendments and their possible effects on the transfer of the remaining airports. He informed senior management responsible for airport transfers that he was concerned about the rent inequities among airports. The Department noted that it had considered the views of the official, but it was unable to provide us with any supporting documentation or analysis.

10.99 As part of the fairness issue, we also assessed Transport Canada's adherence to some of the key principles under the blanket authority it had received in 1996. We looked at the financial elements that were to be predetermined before negotiations and fixed for the duration of the lease to see how the Department had applied them to the leases in our sample. Transport Canada was unable to demonstrate how the significant differences among airports in, for example, the base revenue per passenger and the base operating and capital cost amounts (three key components of the CAA rent formula) ensured equity and fairness among the transfer deals. These were items that the government had directed were to be predetermined and fixed, not negotiable. The Department confirmed that in its effort to adapt the LAA rent formula at Edmonton and Calgary to the CAA formula, it had negotiated the items. These financial elements have a direct impact, dollar for

Exhibit 10.18

Comparable Airports
1998 Passenger Traffic – Airports Transferred or to Be Transferred to Airport Authorities

Tier*	British Columbia	Prairie Region	Ontario	Québec	Atlantic
1	Vancouver 14,870,539		Toronto 25,599,226		
2		Winnipeg 2,641,940 Calgary 7,884,096 Edmonton 3,762,345	Ottawa 2,939,868	Montreal-Dorval 7,900,132 Montreal-Mirabel 1,169,918	Halifax 2,609,288
3	Victoria 1,123,439 Kelowna 897,845	Regina 836,538 Saskatoon 769,955			St. John's 755,585
4			Thunder Bay 476,525	**Quebec City 663,418**	
5	**Prince George 311,918**		London 320,230		Moncton 257,205 Saint John 186,156 **Fredericton 199,291** Charlottetown 156,107
6					**Gander 104,016**

*Transport Canada's assessment of comparable airports for use in negotiations by passenger volume.

The three territorial NAS airports are not shown above as they were transferred to territorial governments.

Note: Airports still to be transferred are shown in bold.

Source: Transport Canada

Exhibit 10.19

Calgary Renegotiated Formula Elements and Rent Ceiling, 1996

> *"...after renegotiation, the final agreements treated comparable airports differently. For example, only Calgary's renegotiated lease included, in effect, a ceiling on its total rent (base rent and participation rent) for 10 years — Transport Canada having agreed to a* *passenger cap* *below the actual number of passengers at the time of renegotiations and having eliminated the clause requiring the payment of* *participation rent**." (paragraph 10.95)*

		Base Revenues			Base Costs		Base Rent	
		Revenues without passenger cap	Revenues with passenger cap	-		=	Rent without passenger ceiling	Base rent ceiling
Standard revenue per passenger		$8.31	$8.31					
Multiplied by number of passengers	Actual	× 6,662,242**						
	Cap		× 6,100,000*					
		55,363,231	50,691,000	-	$33,234,819	=	$22,128,412	$17,456,181*

+

Percentage				
Actual Revenues	-	Base Revenues	=	Participation Rent
N/A		N/A		0

*Per ground lease amendment

** Actual passengers

Source: Transport Canada

and second rounds of transfers were not applied consistently in the renegotiations. In fact, while the deals were being renegotiated, the Department's chief negotiator (who had negotiated the original LAA deals and the first few CAA deals) had some concerns about the amendments and their possible effects on the transfer of the remaining airports. He informed senior management responsible for airport transfers that he was concerned about the rent inequities among airports. The Department noted that it had considered the views of the official, but it was unable to provide us with any supporting documentation or analysis.

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		Base Revenues		-	Base Costs	=	Base Rent	
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	Cap		× 6,100,000*					
		55,363,231	50,691,000	-	$33,234,819	=	$22,128,412	$17,456,181*

+

Percentage					
Actual Revenues	-	Base Revenues	=	Participation Rent	
N/A		N/A		0	

* Per ground lease amendment

** Actual passengers

Source: Transport Canada

dollar, on the rent to be paid to the Crown. A dollar more in base capital cost means a dollar less in rent — for the duration of the lease.

10.100 In the case of Moncton, Transport Canada's own projection showed that notwithstanding the general requirement under the National Airports Policy for self-sufficiency within five years, had Transport Canada continued to operate the Moncton airport, the airport would have continued to experience significant cash flow deficits for at least 20 years.

10.101 We note that other government departments have started to make use of "fairness monitors", who focus on ensuring integrity and fairness in alternative delivery arrangements. In our September 1999 Report, for example (Chapter 18, Public Works and Government Services Canada — Alternative Forms of Delivery: Contracting for Property Management Services), we noted that a significant feature of the contracting process was the use of fairness monitors to provide the Department's senior management with independent assurance that the process was conducted fairly and in accordance with the rules. In view of the complexity of airport transfer negotiations and renegotiations, this practice could be beneficial to Transport Canada.

Toronto deal has been renegotiated

In 1997, Transport Canada renegotiated its lease agreement with the Greater Toronto Airports Authority only a few weeks after signing it. In effect, the airport authority was granted a rent reduction of $185 million for capital works projects at the airport.

10.102 In 1997, Transport Canada renegotiated its lease agreement with the Greater Toronto Airports Authority only a few weeks after signing it. In effect, the airport authority was granted a rent reduction of $185 million for capital works projects at the airport; $103 million of this was credited in the first year, for a total provided to date of $118 million. Our review of the documentation shows that the Department issued a press release when the rent reduction was announced, indicating that it was designed to cover principally a de-icing facility and a north-south parallel runway. We also note, however, that at the time of the airport's transfer to the GTAA the Department had issued a press release that stated, "Several of these projects initiated by Transport Canada in advance of the transfer of the airport to local control were completed earlier this year. With today's transfer, however, the completion of the remainder, including a new north-south runway and a dual taxiway storm water capability in a centralized aircraft de-icing system, becomes the responsibility of the GTAA." Because of those contradictory public statements, we asked the Department to provide us with evidence to demonstrate that, at the time of transfer, the federal government had a legal commitment to finance the north-south runway and the centralized aircraft de-icing facility. There were no undertakings to this effect in the original deal, and Transport Canada was unable to provide us with any support other than the press release described above and the questions and answers prepared for use by its officials when the Department announced the rent reduction.

10.103 We have various concerns about this rent reduction. First, Transport Canada has always considered it a basic transfer principle that airports would be transferred "as is, where is". Second, the Department could not provide us with the rationale for changing the principle of "as is, where is", nor were decision makers made aware of this change. Third, we are concerned that it reopened a long-term (60-year) agreement very soon after signing it to deal with a short-term funding need, even though it had not done any analysis. As a result of the reopened negotiations, the government will receive an estimated 7 percent less rent over the 60-year term of the lease on a net present value basis.

10.104 Moreover, Transport Canada did not conduct any analysis to determine how the Toronto airport rent reduction of $185 million would impact on fairness to other airport authorities.

10.105 Moratorium on renegotiations. In 1997, following the approval for renegotiations at Toronto, Edmonton, Vancouver and Calgary, the Treasury Board put a moratorium on any significant future amendments pending the completion of a major review of the first round of airport transfers (the five-year review) and/or the development of an appropriate framework. As noted, this review was being finalized at the end of our audit.

10.106 Before finalizing transfer deals and renegotiated agreements, Transport Canada should ensure that those agreements undergo review and challenge by officials independent of the negotiating team to ensure that the information is complete and reliable and that the transfers are consistent with the principles established by the government.

Department's response: *Transport Canada disagrees with the Office of the Auditor General's conclusions with respect to fair market value and no worse off. Transport Canada exercised due diligence and followed sound management practices throughout the transfer process.*

- Determining fair value prior to transfer: *Transport Canada determined the fair value of the airports prior to their transfer, although the Department used a different approach from that preferred by the Office of the Auditor General (see paragraph 10.65). Based on advice obtained from independent financial experts, net present value of net cash flow was determined to be the most appropriate approach for determining fair value. Independent financial experts also advised the Department that formal opinions on fair market value were considered less relevant, particularly given that the government's policy was that airport divestiture would not involve an open market situation. The methodology used by Transport Canada to obtain fair value to the Crown was disclosed to and approved by decision makers.*

- Establishing an appropriate benchmark: *Transport Canada established a floor position prior to negotiating each airport transfer.*

- Assessing and reporting the financial impact of airport transfers: *Transport Canada fully recognizes the importance of assessing and reporting the financial impact of airport transfers. The Department will undertake a review that will assess the financial impact of airport transfers.*

- Information to decision-makers: *Transport Canada followed standard government practice wherein the Treasury Board Secretariat plays an independent review and challenge role with respect to Treasury Board submissions. Regarding the airport transfers, all transfer deals, renegotiations, and changes to the financial terms must be approved by Treasury Board. In fulfilling this requirement, Transport Canada provided officials at the Treasury Board Secretariat with all of the necessary information, including all major changes to the final agreements.*

- Adherence to principles established by the government: *Transport Canada fully recognizes and appreciates that legitimate differences between airports exist in terms of, for example, the level of financial maturity, previous capital investment, and costs and revenues; the age of major capital assets; and the needs of the passengers and communities served by the airport. To ensure fair, equitable and consistent treatment among airports, Transport Canada used the same criteria, principles and approaches. The Department also recognized other mechanisms beyond the lease that met the essence of the Public Accountability Principles. Particular emphasis was placed on negotiating comparable deals for comparable airports. Furthermore, the Department uses, for all airport transfers, common legal documents, a common rent*

In 1997, the Treasury Board put a moratorium on any significant future amendments pending the completion of a major review of the first round of airport transfers and/or the development of an appropriate framework.

formula and rent definitions, and a common methodology for preparing amounts in the lease formula.

Transport Canada's Performance in Post-Transfer Matters

10.107 With the transfer of airports to airport authorities, Transport Canada has assumed a new role and gained some new responsibilities. Under the National Airports Policy, it is responsible for guaranteeing the continued integrity and viability of the National Airports System. As landlord of the transferred facilities, it ought to oversee the operations of the airports and related businesses to ensure that they comply with the transfer policy and with transfer arrangements such as leases, agreements to transfer, and by-laws of the airport authorities. Although ensuring safety and security at transferred airports is a key responsibility of the Department, as noted earlier, our current audit excluded safety and security aspects.

Eight years into the transfer process, the Department has yet to define its role as overseer of the National Airports System and guarantor of its integrity and viability.

Transport Canada has yet to define its role in post-transfer matters

10.108 Aside from safety and security, we note that eight years into the transfer process the Department has yet to define its role as overseer of the National Airports System and guarantor of its integrity and viability. We are concerned that the lack of clearly defined roles and responsibilities for post-transfer matters has affected its ability to fulfil its current operational responsibilities in overseeing airport operations. This may have significant negative effects in the future.

10.109 Since 1992, the Department has adopted a predominantly hands-off approach to its landlord responsibilities. It has been largely passive about monitoring and overseeing the NAS. At the conclusion of our audit, the Department told us that now that NAS transfers are coming to a close and it has some experience in its landlord and oversight role, it will be able to devote more effort to post-transfer matters.

10.110 Because the Department had not elaborated its new roles and responsibilities, we did not undertake a detailed audit in this area. We did, however, take a preliminary look, and we noted the following areas in need of urgent attention.

Transport Canada has not developed its position on the growing use of airport improvement fees

10.111 Airport improvement fees (AIFs) have become an increasingly important source of revenue for airport authorities since they were first introduced in 1993. In 1998, airport authorities with AIFs collected $116 million in fees, or 22 percent of their combined total revenues (see Exhibits 10.9 and 10.10). At the conclusion of our audit, 15 NAS airports were charging airport improvement fees.

10.112 We found that the Department has been slow in collecting data and analyzing and assessing the reasonableness of the escalating airport improvement fees. The lack of detailed information on AIFs is disconcerting.

10.113 We also found that information about these fees that was presented to Treasury Board in 1992 was incorrect in one key respect. When the use of airport improvement fees to fund airport expansion was first contemplated, Transport Canada told decision makers that the fees would be subject to the *Competition Act.* However, airport authorities are virtual monopolies and enjoy a captive market. The monopolistic aspects of airport business, one of which is the charging of AIFs, are not covered by the *Competition Act,* unlike concession business such as parking. The Department was aware of this fact as early as 1994, but it did not inform Treasury Board and has missed several opportunities since then to do so. Although the Public

Accountability Principles require CAAs (second-round transfers) to ensure that all user fees are reasonable, the Department has yet to do any substantive oversight of the reasonableness of existing AIFs.

10.114 In its five-year review, the Department found that there is little information on how airport authorities use revenues from airport improvement fees. It also found that some airport authorities have yet to conduct any costing studies to determine whether their fee structures and rates are reasonable and comply with provisions in their leases that pertain to obligations under national and international agreements. The review noted that airport improvement fees could be increased significantly at the first-round NAS airports without affecting traffic. It indicated that some stakeholders had concerns about the use of AIFs, including the quantum of fees that were being charged and the lack of redress mechanisms for the general public.

10.115 Transport Canada should move quickly to deal with the issues raised in the five-year review. It should clarify its role in the monitoring of airport improvement fees and communicate the results to decision makers along with recommendations as appropriate.

Department's response: *See response following paragraph 10.139.*

The advent of subsidiaries

10.116 Airport authorities have used subsidiaries to expand their business horizons. At the time of our audit there were at least 13 such subsidiaries, most of them wholly owned by the airport authorities created before 1994 (the LAAs).

10.117 Activities of subsidiaries include airport management and operational services, airport marketing and consulting services, and business ventures such as investment in airports in Eastern Europe, South America and the South Pacific. There are different types of investments by airport authorities — wholly owned subsidiaries and minority-interest investments. Wholly owned subsidiaries can also have subsidiaries.

10.118 The Department has yet to systematically assess any of the subsidiaries or their business arrangements to review, for example, the potential risks to the Crown, and the financial implications of their activities for the operations of airport authorities and the rents they pay. We note that the transfer arrangements give Transport Canada the right to audit the activities of the airport authorities' subsidiaries, but since their emergence seven years ago it has yet to do so.

10.119 At a minimum, we would have expected Transport Canada to have such basic information on each subsidiary as:

- its board members;
- the remuneration of board members and senior executives;
- separate audited financial statements;
- disclosure of conflicts of interest and a description of transactions between related parties; and
- a list of contingencies, guarantees and commitments made by subsidiaries or by airport authorities on their behalf.

10.120 We are concerned that Transport Canada does not know the extent of airport authorities' business activities and has yet to assess the attendant financial risks.

10.121 Rent-related risk. Transport Canada does not know whether airport authorities have transferred the ownership of profitable businesses or intellectual property to off-site subsidiaries. Under the LAA lease formula, this practice would affect the rents that Transport Canada collects. (Rent is payable only on activities carried out on the airport site itself or on revenue from a local airport

The Department's five-year review noted that some stakeholders had concerns about the use of airport improvement fees, including the quantum of fees that were being charged and the lack of redress mechanisms for the general public.

The Department has yet to systematically assess any of the airport authorities' subsidiaries or their business arrangements to review, for example, the potential risks to the Crown.

authority competing business within three kilometres of the airport.)

10.122 Offshore risks. Transport Canada has yet to assess the financial and political risks of airport authorities' offshore investments. The potential costs involved in loan guarantees and equity investments, along with the possibility of economic or political instability in certain countries, could affect the viability of subsidiaries and, potentially, the viability of the airport authorities themselves. If a subsidiary defaulted on a loan and the parent airport authority had to assume responsibility for repayment, the authority might be unable to meet its rent commitments to the Crown.

10.123 Other risks. Transport Canada does not know whether the authorities have guaranteed loans from other lenders to subsidiaries. Any such guarantees would create contingent liabilities for the airport authorities that, in turn, could translate into costs for the Crown. The Department recently obtained limited and unaudited financial information on subsidiaries that suggests that in 1997 they generated a total of about $16.3 million in revenues, had assets of $25.7 million, and posted a net loss of $53,000. They had also received about $17 million in interest-free loans from parent airport authorities.

10.124 In December 1999, as part of its five-year review, the Department noted that airport users and other interested parties had concerns about the relationship between airport authorities and their private sector subsidiaries. They considered that the primary focus of the authorities and their boards of directors ought to be on overseeing the operation of first-class airports.

10.125 As part of its ongoing oversight of the National Airports System, Transport Canada should develop a systematic approach to monitoring and overseeing the activities of airport authorities' subsidiaries. It should collect the necessary information to assess the impact of those activities on the authorities' rent and financial performance. It should report periodically to the Treasury Board or Cabinet on the implications for the public interest and should make recommendations as appropriate.

10.126 Transport Canada should complete its five-year review and alert the Treasury Board or Cabinet to any gaps in policy or accountability related to the use of subsidiaries by airport authorities.

Department's response: *See response following paragraph 10.139.*

Use of sole-source contracts by airports versus government's objectives of equal access and best value

10.127 The airport authorities established before 1994 (the LAAs) were not required by their original leases to tender any of the contracts they let — that is, to open them to competition in order to receive optimal value and to embrace the public sector value of equal access by suppliers. In contrast, the authorities established since the 1994 National Airports Policy (the CAAs) are expected to follow the Public Accountability Principles, which require them, as a general practice, to tender all contracts over $75,000 for goods and services. If a CAA does decide to sole-source a contract, its annual report must disclose information on the contractor, indicate the dollar value of the contract and justify the decision to award the contract without competition. There is currently no such requirement for most LAAs.

10.128 Transport Canada reviewed the 1998 annual report of the Greater Toronto Airports Authority (GTAA), a Canadian airport authority. The report listed a significant number of sole-source contracts over $1 million. In the Department's view, information in the report did not meet the requirements of the Public Accountability Principles, which require disclosure of the dollar value of each sole-source contract over $75,000. Moreover, sole-source contracts for concession revenues were not disclosed at all. The current lease agreement does not contain any clause that would penalize the authority for not complying with the disclosure requirement. The Department has advised the GTAA of its concerns and is working with the authority to resolve the issue.

10.129 Other than reviewing information in authorities' annual reports for what is disclosed, Transport Canada has yet to review the extent to which other airport authorities are using sole-source contracts and reporting on them appropriately.

10.130 Transport Canada should periodically review contracting matters in transfer agreements to ascertain whether they adequately reflect public sector values. It should alert decision makers to its findings and make recommendations as appropriate, including enforcement considerations such as penalties for non-compliance.

Department's response: See response following paragraph 10.139.

A largely hands-off approach to landlord responsibilities

10.131 Leased airports in the National Airports System are diverse. Some are unique — Pearson International, for example, by virtue of its size. Each has its own regional economic realities and all are at different stages of growth and expansion. Transport Canada's head office and five regions administer and co-ordinate the Department's landlord-related responsibilities for the NAS. Until 1997, all of the landlord activities were centralized at headquarters in Ottawa because only four airports had then been transferred. Consequently, at most regional offices the landlord role for NAS airports is a relatively new responsibility.

10.132 Transfer of corporate knowledge. The Department has yet to establish a formal training program to educate employees about lease management matters. Consistently in our meetings at all of the Department's five regional offices, staff indicated a need for such training. They noted that significant downsizing in the recent past had resulted in a substantial loss of corporate memory about airport matters. Moreover, they believed a formal training program would help them develop the skills required to move from operator to landlord of NAS airports. Regional staff also noted that they lacked some fundamental knowledge about the rationale for some of the negotiated terms in the leases they are required to administer. The Department had yet to establish a formal process for negotiators to convey critical knowledge implicit in the negotiated leases. As a result, regional staff felt they were not on a level playing field in their dealings with airport authorities and thus risked mishandling aspects of the leases.

Regional staff of the Department noted that they lacked some fundamental knowledge about the rationale for some of the negotiated terms in the leases they are required to administer.

10.133 Auditing airport authorities. According to the leases, the Department has the unrestricted right to audit airport authorities. In keeping with its hands-off approach, however, Transport Canada has not exercised this right at any of the major airports since 1995, when it audited the four LAAs to assess their compliance with the financial aspect of the lease formula. Those audits raised many issues that impacted on the amount of rent received by the government, and we are concerned that some are still unresolved. The Department informed us that in the summer of 2000 it would develop an audit program for auditing airport agreements, which would include issues raised in its previous audits.

In keeping with its hands-off approach, Transport Canada has not exercised its right to audit airport authorities at any of the major airports since 1995.

10.134 Standards and criteria. We found that the Department has not developed standards or criteria for assessing how well authorities are complying with certain key aspects of their leases.

10.135 Leases specify that an airport authority must provide a "first-class" facility. However, the leases do not define this in terms of the size and nature of a facility and the level of services it should provide, other than having the capacity to meet the demand for service of communities within a 75-kilometre radius of the airport.

10.136 Standards and criteria would assist the Department in carrying out appropriate, effective and timely monitoring of airport expansions to help ensure that they are in line with community interests and that it can alert the Minister, Cabinet and/or the Treasury Board to any potential problems. They could help, for example, to identify overbuilding and extra costs and the potential risks to the integrity and viability of the National Airports System.

The Department has neither carried out a comprehensive study nor performed any systematic monitoring of the financial health and viability of the National Airports System as a whole.

10.137 We note that airport leases require airport authorities to review and report on their own performance every five years. However, we are concerned that Transport Canada has not communicated to airport authorities its requirements and interests as overseer and landlord of the system. Consequently, it may not be able to ensure that the reports fully meet its information needs.

10.138 Transport Canada should, without delay, establish a formal training program to transfer critical knowledge and skills to its regional staff responsible for lease management, and it should ensure the continuing development of those skills over time.

10.139 Transport Canada should define its role in post-transfer matters as overseer and landlord of the National Airports System together with the systems and practices it needs to discharge that role, including the level of audit activity required.

Department's response: *Transport Canada agrees that its role as landlord and overseer of the National Airports System should be clear to stakeholders and parliamentarians. Transport Canada had already identified these and other issues through its LAA Lease Review process and was planning to deal with them as part of a comprehensive package. Direction to be received in fall 2000 and actions arising from the results of the five-year review will further clarify Transport Canada's and the government's role in post-transfer matters, including those areas identified by its five-year review.*

Transport Canada will continue to take steps to strengthen its existing landlord role. Examples of some of the activities currently under way include:

- *developing a lease monitoring matrix and supporting schedules to ensure a national approach to the treatment of the leases, taking into account the specific terms and conditions of each lease;*
- *implementing a more rigorous lease monitoring program that will, where appropriate, include an assessment of airport authorities' contracting practices; and*
- *establishing a national program to transfer critical knowledge and skills to all staff responsible for lease management.*

Transport Canada's oversight of financial viability lacks rigour

10.140 In 1997, the Department looked at the financial viability of a few less-viable airports that had yet to be transferred. Its five-year review looked at the financial viability of only the four airports transferred in the first round. The Department has neither carried out a comprehensive study nor performed any systematic monitoring of the financial health and viability of the NAS as a whole.

10.141 In our view, a systematic approach to monitoring is long overdue. However, the Department has informed us that it will study the financial viability of the NAS only after a decision has been made to conduct a comprehensive review of the National Airports Policy. It believes that such a review could be carried out only after enough time has passed to permit meaningful results to emerge. We disagree with the Department. Monitoring the financial health of the system is something that needs to be done on a proactive, ongoing basis. It is fundamental to basic oversight activities.

10.142 We find that the delays implicit in the Department's position on monitoring may place the public purse at undue risk. The Department's position on this matter is also worrisome in light of the fact that the National Airports Policy publicly commits Transport Canada to guarantee the long-term viability and integrity of the National Airports System. The Policy clearly recognizes that the system is of vital importance to Canadians.

10.143 The underpinnings of a comprehensive study and systematic monitoring of the National Airports System's viability would include, in our view:

- developing benchmarks against which to assess financial viability;
- identifying the main drivers of financial performance and the associated risks;
- drawing comparisons with other jurisdictions;
- analyzing the ability of all NAS airports to absorb operational losses and replace aging capital infrastructure; and
- carrying out an analysis of government support and other financial commitments, together with sensitivity analyses to project into the future.

10.144 As yet, Transport Canada has neither defined its data needs nor begun to collect and maintain the generational databases it needs to both support its oversight responsibilities and facilitate the more specific analysis required for policy development. Such data could also be used for periodic assessments of the System's financial viability to support decision making throughout the 60-year term of the leases.

10.145 We found that the Department has been reactive in assessing emerging financial risks. The recent airline restructuring issue is one example. We note that only in November 1999 did the Department begin to study the financial viability of NAS airports in the context of airline restructuring. At that time, parliamentarians were expressing a keen interest in having better information on this subject. However, the Department informed us that its study would provide only a theoretical and largely qualitative assessment of the impact of airline restructuring on certain specific airports. Consequently, it would not provide a definitive view of the viability of the NAS as a whole. The study was still under way at the time of our audit.

10.146 During our discussions with various airport authorities, several stressed the need for the Department to have a clearer vision both of how the National Airports System overall should function and of the Department's role in ensuring that the System functions at an optimum level. We noted that Transport Canada has yet to establish any specific performance objectives and measures for the System that focus on outcomes — on what the NAS ought to be achieving in areas such as sustainable development, international competitiveness, and accessibility.

10.147 Transport Canada should design and formalize a framework for monitoring the long-term viability, integrity and overall performance of the National Airports System. It should collect the necessary quantitative and qualitative data to perform timely analyses. To the extent that it relies on airport authorities or other sources for underlying data, the Department should clearly specify the type and format of

the data it requires from them and should establish procedures to verify that the data are reliable.

10.148 The Department should periodically report to Parliament and other stakeholders on the performance of the National Airports System as a whole.

Department's response: *Transport Canada agrees that performance monitoring and reporting are critical to its oversight and landlord role. As part of fulfilling this role, Transport Canada currently has comprehensive monitoring programs in place to monitor the leases and airports, and for policy development purposes.*

The Department has defined the data types and format for some areas, and currently collects some information on airports. Most of the data are drawn from reliable sources, for example, audited statements and data from specialized statistical agencies such as Statistics Canada. Transport Canada recognizes that improving performance monitoring and reporting is an ongoing process that will require further time and effort. The Department will take steps to strengthen its data collection, validation and monitoring practices, where appropriate.

Airport authorities are still not subject to the *Canadian Environmental Assessment Act*

10.149 Although Transport Canada is not the lead department for ensuring the relevance and completeness of the provisions contained in the *Canadian Environmental Assessment Act,* the status of provisions in the Act has ramifications for the operations the Department has transferred. Transport Canada noted in its five-year review of airport transfers that there was a lack of regulatory support for environmental assessment matters and that this made it difficult for the local airport authorities to impose environmental assessment standards on tenants. In addition, it is not clear what standards apply to various aspects of airport authority operations. As the Commissioner of the Environment and Sustainable Development first observed in 1998, airport authorities are not subject to the provisions of the *Canadian Environmental Assessment Act*. The government's stated intention to develop regulations under the Act has not been carried out. This is worrisome, given the hundreds of millions of dollars in capital works projects under way on National Airports System lands and facilities. Although some airport authorities appear to be proactive in this area, there is no legal requirement for them to conduct formal environmental assessments of their projects.

Although some airport authorities appear to be proactive in environmental assessment matters, there is no legal requirement for them to conduct formal environmental assessments of their projects.

10.150 As a federal department, Transport Canada is subject to the provisions of the *Canadian Environmental Assessment Act.* Generally, any subsidy it pays — directly or indirectly — is subject to the Act. But there appear to be some exceptions. For example, the federal government would not be required to perform an environmental assessment in support of a subsidy it provided to airports, such as negative rent or rental credit, if the subsidy were not linked to a specific project. The greater proportion of the several hundred million dollars to date in approved rent reductions or negative lease payments has not been linked to specific projects. According to the Department, airport authorities were to direct much of these savings on rent to capital works projects. Until such time as the government's stated intention to develop the regulations under the *Canadian Environmental Assessment Act* is carried out, there is a need for Transport Canada to consider the appropriateness of funding future expansion projects at airports without explicitly requiring environmental assessments from airport authorities and conducting appropriate screening of those assessments.

Federal enabling legislation for transfer of airports dates back to 1992

10.151 It should be noted that the *Airport Transfer (Miscellaneous Matters) Act* is the enabling legislation for airport transfers. It was proclaimed in 1992, in the year of the first round of airport transfers, when the government still owned and operated over 100 airports. Unlike some other statutes, this Act has no provision for its formal review after five years for currency and relevancy. The Act is also silent on enforcement matters such as penalties that Transport Canada could impose on post-transfer activities.

10.152 Rent credits to subsidize capital works at airports, and other forgiveness of rent, lack transparency to Parliament. Although rent credits and other rent reductions negotiated by Transport Canada permanently reduce revenues to the Crown, there is no requirement for specific approval by Parliament in the Estimates process — unlike other federal financial support such as payment of a grant or contribution. Even though the purpose of rent credits and other financial support is similar to that of grants and contributions and, in a number cases, reduces revenues otherwise due the Crown, government policy does not require the Department to disclose that information to Parliament. Transport Canada notes that it follows the government policy. In our opinion, the government policy does not preclude the disclosure of relevant and pertinent information. We observed that the information on rent credits and other forgiveness of rent in the Department's Estimates documents and/or its annual Report on the State of Transportation in Canada was fragmented, incomplete, and in some years non-existent. As noted, rent credits and other forgiveness of rent that the Department has negotiated with airport authorities have been significant — $474 million so far. Of the $210 million forgone from 1992 to 1999, only $97 million was reported to Parliament. With respect to the remaining $264 million, no information on this future commitment has been disclosed.

10.153 Transport Canada should, through the Estimates process and other accountability reporting to Parliament, make transparent the rent credits and other forgiveness of rent negotiated with airport authorities.

Department's response: *Transport Canada has fully met its obligations under current government policy. As noted by the office of the Auditor General, government policy does not require departments to report rent credits and other similar financial support to Parliament. That being said, Transport Canada recognizes the importance of increasing transparency to Parliament and the public. With the implementation of the Financial Information Strategy (FIS), the Department expects to report rent credits and other forgiveness of rent negotiated with airport authorities. As per standard government practice, the Department's financial statements will be made available to Parliament and the public.*

Information on rent credits and other forgiveness of rent in the Department's Estimates documents and/or its annual Report on the State of Transportation in Canada has been fragmented, incomplete, and in some years non-existent.

Conclusion

10.154 During the last seven years, Transport Canada has transferred 18 of Canada's largest and busiest airports to airport authorities. At the conclusion of our audit, only four airports in the National Airports System remained to be transferred . Yet Transport Canada had already renegotiated four leases, had given a qualified undertaking for at least three more renegotiations under certain conditions, and was being pressured by several authorities to enter into more renegotiations.

10.155 Our audit of the Department's handling of airport transfers, including the renegotiations, revealed many significant weaknesses in its management practices. In particular, Transport Canada did not assess the fair market value of the airports to be transferred before it entered into the second round of negotiations and any renegotiations. It has yet to come up with a framework for evaluating and reporting on the overall financial impact of the transfer initiative. In addition, some of the information provided to decision makers in support of the transfers was incomplete and inaccurate, and in the transfer process the Department failed to adhere to some key government directions. Contributing factors may have been the absence of a formally codified application framework in support of airport transfers, including renegotiations, and the lack of independent review to determine whether proposed final deals adhered to government directions.

10.156 We found that Transport Canada has yet to define its post-transfer role as overseer of the National Airports System and guarantor of the System's integrity and viability. Nor has it clearly defined its role as landlord of the transferred facilities. We found that its approach to dealing with emerging issues is far too passive, and lacks rigour in certain respects. Among other things, the Department has failed to assume a leadership role and to properly monitor the growing use of airport improvement fees, sole-source contracting at major airports, and activities of subsidiaries in order to ensure that the interests of the public are protected.

10.157 The Department has also been slow to complete its five-year policy review of airport transfers. Preliminary results have pointed to a number of concerns. Transport Canada needs to move quickly to finalize the review and make its observations and recommendations known to decision makers.

10.158 Overall, we believe there is a pressing need for Transport Canada to demonstrate more diligence in its handling and oversight of NAS airport transfers, including any renegotiation of transfer agreements and related accountability reporting to Parliament.

About the Audit

Objective

Our overall objective was to assess Transport Canada's management and administration of airport transfers since 1992, its oversight of the National Airports System as a whole and its performance as landlord of airport facilities.

Scope

Our audit focussed on Transport Canada's responsibilities relating to the National Airports System. We carried out our audit in the context of eight of the largest airports: Victoria, Vancouver, Edmonton, Calgary, Toronto, Ottawa, Montreal (Dorval and Mirabel) and Moncton. All are part of the National Airports System, representing 85 percent of its traffic in 1998 and just about all of Transport Canada's lease revenues. While we looked at aspects of negotiated lease arrangements for each of the NAS transfers in our sample, we do not provide any assurance or opinion on the overall quality and effectiveness of any one lease.

The following areas were excluded from the scope of our audit:

- Transport Canada's current negotiations of transfer agreements to complete the transfer of NAS airports;
- the transfer of non-NAS airports to territories, provinces, municipalities or private interests;
- Transport Canada's management of the Airport Capital Assistance Program;
- the performance and effectiveness of the boards of directors of individual authorities;
- the decision to cancel the transfer of Lester B. Pearson International Airport;
- the safety and security aspects of airport operations; and
- the management and administration of the first round of airport transfers.

Criteria

We expected to find the following:

Policy. Decisions regarding airport transfers and the management of the National Airports System would be guided by clear policies, protect the interests of the taxpayers, and information presented to decision makers would be accurate, relevant, timely and complete.

- Policies with respect to airport transfers and the management of the National Airports System would be updated as and when required for currency and completeness.
- Transport Canada's roles and responsibilities in and for the National Airports System would be clearly defined and appropriate governance and accountability would be in place, including mechanisms for reporting back to decision makers on related performance.

Implementation. Agreements entered into with airport authorities would reflect government directives and facilitate the effective discharge of Transport Canada's landlord responsibilities.

- Sound management practices would be followed in the management and administration of agreements with Authorities and for the National Airports System as a whole.
- Transport Canada would keep abreast of emerging issues to ensure that Crown assets were protected and taxpayers' interests appropriately safeguarded.

Reporting. Transport Canada would appropriately monitor, evaluate and report to decision makers and Parliament on the results and impacts of airport transfers, the functionality of the National Airports System and the management of leased facilities.

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Chapter 11
Human Resources Development Canada –
Grants and Contributions

October 2000

This October 2000 Report comprises 8 chapters as well as a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 11

Human Resources Development Canada

Grants and Contributions

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Human Resources Development Canada

Grants and Contributions

Main Points

11.1 Our audit examined four of the grant and contribution programs included by Human Resources Development Canada (HRDC) in its 1999 internal audit. We concluded that there were widespread deficiencies in the management control frameworks of all four programs. Our findings, which covered the period to December 1999, confirmed — and extended — those of the Department's 1999 internal audit. Among other things, we found breaches of authority, payments made improperly, very limited monitoring of finances and activities, and approvals not based on established processes.

11.2 The results that projects were to achieve were often not defined in terms that could be measured. Even when they were (as in the case of Youth Internship Canada), results were not measured systematically to provide managers with feedback for making necessary improvements and to provide a basis for accountability. Some evaluation of these programs had been done. The evaluations of the Sectoral Partnerships Initiative and Transitional Jobs Fund resulted in some program changes. However, we could not support the Department's findings on the effectiveness of the Transitional Jobs Fund.

11.3 The Department's review of 37 "problem files" identified by its internal audit for further follow-up established few cases where money could be recovered from project sponsors, because most payment errors resulted from inappropriate practices by departmental staff. Many of these practices are not acceptable — proceeding without required approvals, relying on oral contracts and paying for ineligible expenses, for example. Reporting by HRDC on the results of the review focussed on overpayments and provided little information on the problems found.

11.4 Current management is committed to addressing the serious weaknesses in the management control framework in the period up to December 1999 that our audit and the 1999 internal audit identified. HRDC has corrective action planned and being implemented in response to the problems identified in its 1999 internal audit. The actions and plans also address the deficiencies we found in our audit.

11.5 The Department has made good progress toward meeting the commitments in its Six-Point Action Plan announced in February 2000. Management is enhancing the tools and the support available to staff to improve their ability to do their jobs. Work is also proceeding on additional initiatives that expand or complement the original action plan.

11.6 HRDC management will need to sustain its efforts and attention if it is to achieve the broad-based systemic change the action plans envision. Beyond the immediate corrective steps the Department has taken, it needs to make today's extraordinary effort tomorrow's routine and fundamentally change its day-to-day approach to the delivery of grants and contributions. Management and staff of the Department need to continue the current focus on the fundamentals of control. Minimum standards of control must be in place for all projects. However, time and effort needed to review and assess proposals, monitor progress, assess performance, and evaluate results should vary with the amount of federal funding involved and the risks associated with the project.

11.7 HRDC has established an innovative system of tracking performance — one that allows for tracking improvements in the management and administration of grants and contributions. Ongoing performance tracking and internal audit are essential tools for assessing improvements in the management control framework.

Background and other observations

11.8 HRDC spent about $3 billion in 1999-2000 on grants and contributions for programs such as job creation and youth employment, as well as for employment benefits and support measures. We examined in detail four of about 40 grant and contribution programs run by HRDC: the Transitional Jobs Fund and its successor the Canada Jobs Fund, Youth Internship Canada, Social Development Partnerships and the Sectoral Partnerships Initiative.

11.9 HRDC's problems in managing grants and contributions worsened in the 1990s; audits in the late 1990s show the persistence of problems identified in the past. An internal audit in 1991 and its follow-up in 1994 led to little corrective action. Management's priorities then were to implement major policy initiatives and improve service; there was not enough emphasis on maintaining essential controls while red tape was being reduced and service improved.

11.10 More work is required to determine the resources needed to deliver grant and contribution programs. The Department's corrective actions and plans are designed to strengthen capacity by providing staff with appropriate support, training, tools and systems. HRDC is also taking steps to bring in new staff at appropriate levels. It plans to analyze workload to ensure that it has adequate resources in place.

11.11 The programs we audited had made available general information about their existence. For the most part, the promotion of these programs was passive and, in the case of some programs delivered at the local level, varied significantly among regions and local offices. Information was not always provided in a way that would promote equal access to the programs.

The chapter includes the Department's general response and its responses to specific recommendations.

HRDC has responded positively to our findings and recommendations and affirmed that it will continue to sustain the progress shown to date in meeting the commitments of the Action Plan and related initiatives.

Introduction

Grants and contributions are among the means used by government to pursue policy objectives

11.12 The government has many ways to pursue public policy objectives, including legislation and regulation, information and advice, and transfer payments to individuals, organizations and other levels of government. Transfer payments to individuals and to organizations are generally made as grants or as contributions.

11.13 Contributions differ from grants in the requirements imposed on departments and recipients. Grants are unconditional payments. If an individual or organization meets the eligibility criteria for a grant, the appropriate payment can be made without requiring the recipient to meet any other conditions. In contrast, contributions are transfer payments that are subject to performance conditions specified in a contribution agreement. The recipient must continue to show that it is meeting the performance conditions in order to be reimbursed for specific costs over the life of the agreement. The government can audit the recipients' use of contributions, whereas audit is not a requirement for grants. Because they require less accountability, grants need to be reserved for only those situations where it is demonstrably appropriate for transfers to be unconditional.

11.14 Programs that provide for grants or contributions may involve statutory or voted expenditures. Statutory expenditures are those that have been given continuing authority by Acts of the current or a previous Parliament and therefore do not require annual parliamentary approval. Voted expenditures are those for which parliamentary authority is sought through an annual *Appropriation Act*.

11.15 Human Resources Development Canada (HRDC) administered roughly $60 billion in 1999-2000 — the bulk of it on transfer payments. Most took the form of statutory grants such as Canada Pension Plan benefits, Old Age Security and Guaranteed Income Supplement payments under the *Old Age Security Act*, and Employment Insurance benefits under the *Employment Insurance Act*. HRDC spent about $3 billion on voted grants and contributions for programs such as job creation and youth employment, as well as for employment benefits and support measures authorized under Part II of the *Employment Insurance Act*. Exhibit 11.1 describes the Department's core service lines and budgeted resources for 2000-01.

HRDC spent about $3 billion on grants and contributions in 1999-2000 for programs such as job creation and youth employment, as well as for employment benefits and support measures.

Persistent shortcomings across government in managing grant and contribution programs

11.16 Our audits in various departments over more than two decades have identified persistent shortcomings in the management of discretionary grant and contribution programs. These shortcomings have ranged from problems of non-compliance with program and legislative authorities to weaknesses in program design, poor financial and management controls, and deficiencies in measuring and reporting results.

11.17 HRDC was created in 1993 from all or major parts of five departments. Included were the employment programs of the Canada Employment and Immigration Commission, providing the basis of a Canada-wide structure for delivery of the new department's programs. Many of HRDC's current grant and contribution programs evolved from programming related to employment and the labour market. In our previous audits of Employment and Immigration Canada and HRDC, we found many of the shortcomings identified recently in the management of grants and contributions. For example:

- In 1983, our audit of Employment and Immigration Canada concluded that

while job creation projects were selected in accordance with program objectives and criteria, inadequate monitoring posed a risk that payments would be made that were not allowable under the contribution agreements.

- Our 1986 audit of two employment creation programs concluded that one of the programs had sidestepped normal administrative procedures. Further, there were few measures to ensure that project and program objectives would be achieved. Rather than public servants, it was ministers and members of the House of Commons who played the dominant role in seeking out applications and selecting projects. The other program was better designed, but the audit showed that in many cases funding for projects or enterprises had been approved based on unrealistic assessments of their continuing viability. Moreover, not enough attention had been paid to creating the permanent jobs that the program's objectives called for.

- The 1992 Report of the Auditor General noted that vague project objectives in a variety of employment-related programs, coupled with imprecisely defined needs and priorities of the local labour market, prevented Employment and Immigration Canada from selecting projects on the basis of merit. Further, the Department did not respect its own minimum requirements for financial and activity monitoring.

- Our 1999 report on the components of The Atlantic Groundfish Strategy (TAGS) that were managed by HRDC relied on work done by the Department's Internal Audit Bureau. Based on its work, we could provide little assurance that all

Exhibit 11.1

HRDC Core Service Lines and Budgeted Resources 2000-2001

	Resources		
Core Service Lines	**Financial ($ millions)**	**FTEs***	**To provide Canadians with**
Income Security	44,090	3,587	Sustainable Income Security Programs for seniors; persons with disabilities and their children; survivors; and migrants.
Employment Insurance Income Benefits	10,117	7,623	Temporary income support to eligible unemployed workers, or individuals who are out of the workplace due to maternity or parental responsibilities or as a result of illness. Confidence in the financial integrity of the Employment Insurance Program.
Human Resources Investment	5,328	3,379	Effective and efficient labour market.
Labour	160	673	Safe, fair, stable and productive workplaces.
Corporate Services and Service Delivery Support	628	5,406	A departmental infrastructure to achieve effective and efficient services. Prompt collection of moneys due to the Crown. Sound administration and financial management of grants and contributions.
Total	**60,323**	**20,668**	

Source: Report on Plans and Priorities, HRDC, 2000-2001 Estimates Part III

* Full-time-equivalent

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contributions made under TAGS had been used for their intended purposes.

11.18 In addition to our audits, internal audits by HRDC and Employment and Immigration Canada have pointed to significant deficiencies in the management of grant and contribution programs:

- A 1991 audit by Employment and Immigration Canada documented significant problems with controls, monitoring, and financial practices. The auditors noted, "There is no doubt that a persistent situation of weak controls will increase the probability of … mismanagement resulting from negligence, abuse and even fraud."
- A follow-up in 1994 found that important recommendations in the 1991 internal audit report had not been implemented, in whole or in part. Control and monitoring continued to be neglected, even in complex, high-value projects.
- In 1998, HRDC's Internal Audit Bureau conducted an audit of grants and contributions under The Atlantic Groundfish Strategy. The audit identified major weaknesses in all aspects of the project life cycle. A review of project files found serious deficiencies in the management, monitoring and control of contribution agreements.
- In its 1999 audit of grants and contributions, the Internal Audit Bureau examined 459 project files from a wide range of HRDC's grant and contribution programs. The audit reported systemic shortcomings in the Department's management of grants and contributions, including numerous weaknesses in control.

HRDC's problems in managing grant and contribution programs worsened in the 1990s

11.19 The management of grants and contributions requires attention to program design, appropriate tools and training for staff, and staff in adequate numbers to deliver the programs. Senior management and central agencies of the government need to ensure that there is appropriate capacity in place to deal with these programs' policy aspects, operations, and financial management and control — as well as appropriate accountability.

11.20 As early as the 1980s, our audits identified problems in the management of grants and contributions. We noted weaknesses in the design of specific programs and in the management of some stages in a project's life cycle — for example, insufficient priority placed on control and monitoring. Early audits of employment-related grant and contribution programs noted the need to ensure that trained staff were sufficient to deliver programs and the need for balance between providing service in communities and having in place proper controls and accountability.

The results of internal audits and our own work show that problems of capacity had become more serious.

11.21 The results of internal audits and our own work show that problems of capacity had become more serious because of many factors, including the priority given to other policy issues, reorganizations and downsizing, as well as the view that controls were of lesser importance. Audits in the late 1990s not only demonstrated the persistence of past problems but also identified systemic problems across the Department's grant and contribution programs and throughout the life cycle of projects.

The Department's emphasis was on service more than control

11.22 Following the creation of HRDC in 1993, management attention was focussed on creating the new department, managing Program Review, and reviewing many major programs under the Department's responsibility — for example, Employment Insurance and the Canada Pension Plan.

11.23 The Department went through several management changes followed by cutbacks and downsizing as part of Program Review, and some of its responsibilities were transferred to provinces through Labour Market Development Agreements. The emphasis among staff at all levels was on improving service. In April 2000 we reported on our audit of HRDC's service quality at the local level, noting that the Department had taken several initiatives to improve service to clients, including putting in place a new service delivery network.

11.24 During the mid- to late 1990s, the Department emphasized the importance of cutting red tape, empowering front-line staff, and increasing the delegation of authority, through its "Breaking the Barriers" initiatives. Other related corporate initiatives included developing a "Results-Based Accountability Framework" and programs to support staff. In contrast, the Department placed little emphasis on the importance of maintaining key financial and management controls. Appropriate controls and monitoring by management must accompany the effective empowerment of front-line staff.

As part of major cutbacks, internal audit resources were reduced.

11.25 As part of the major cutbacks that started in 1995, post-audit, a function to verify payments, was greatly reduced across the Department. The 1994 internal audit report had credited post-audit with the Department's only consistent monitoring of grants and contributions. Operational reviews were also cut. In addition, internal audit resources were reduced from 54 full-time-equivalent staff in 1994-95 to 33 in 1999-2000. Control points were eliminated without adequately considering the risks and the impact on the integrity of departmental controls. Downsizing and the devolution of programs and services to the provinces and to other organizations also led to a loss of corporate memory, experience and capacity — especially at the local level.

11.26 In an environment that emphasized service rather than basic controls, the Transitional Jobs Fund was introduced. Although this program required a new set of assessment skills, it was implemented without any allocation of new resources for its administration and delivery. This reinforced the relatively low priority given to administration. HRDC began to focus on its internal controls and risk management practices toward the end of the 1990s, with the introduction of initiatives related to modernizing comptrollership.

Strong public and parliamentary interest in the Department's 1999 internal audit

11.27 The release of the latest internal audit report in January 2000 generated strong interest from the public and Parliament. The findings resulted in many questions about the sampled programs, including whether funds had been spent properly and desired results had been achieved — particularly in the Transitional Jobs Fund and Canada Jobs Fund programs. In response to the audit findings and public concern, the Department released a Six-Point Action Plan. This led to further questions about whether the actions proposed in the plan could be expected to correct the deficiencies the audit had identified.

11.28 The Standing Committee on Human Resources Development and the Status of Persons with Disabilities undertook a study of the Department's management of grants and contributions. After a series of hearings and many witnesses, the Committee issued a final report in June 2000. It made 30 recommendations and requested a comprehensive response from the government by 20 September 2000.

11.29 The Committee specifically recommended that the Auditor General provide guidance in his next report "on ways to balance efficiency and flexibility in terms of program delivery and the need for sound financial management." As the Committee observed, maintaining a balance of efficiency, flexibility and sound financial management is a significant challenge to public service managers.

11.30 On 22 June 2000 the government announced that the Canada Jobs Fund program would be discontinued, although HRDC would process applications it had already received and would manage any ongoing projects to their completion. The freed-up funds are to be allocated to the regional economic development agencies.

Focus of the audit

11.31 In response to a recommendation by the Standing Committee on Public Accounts, on 8 June 1999 we advised the Chair of the Committee that we would undertake a broad-scoped audit of the management of grant and contribution programs across government. We committed at that time to auditing a number of specific grant and contribution programs, including programs administered by HRDC. When the Department released the 1999 internal audit report and announced steps it would take to correct identified shortcomings, we expanded the scope of our audit in that Department to include an assessment of its progress in implementing corrective action.

11.32 The objectives of our audit were to determine:

- the extent to which reliance can be placed on HRDC's 1999 internal audit and its performance tracking system;
- the Department's progress in implementing its corrective action plan;
- the adequacy of the management control framework for selected grant and contribution programs;
- how HRDC has measured and reported the results achieved by selected grant and contribution programs; and
- the Department's compliance with financial authorities such as the *Financial Administration Act* and Treasury Board policies.

11.33 Our audit examined four programs from the cross-section of programs covered in the Department's 1999 internal audit. Three of the four were selected because they represented a range of expenditures, administration both by headquarters and the regions, grants as well as contributions, and varying degrees of familiarity to the public. The three programs were the Transitional Jobs Fund (budget of $300 million over three years to 31 March 1999) and its replacement program, the Canada Jobs Fund (1999-2000 budget of $110 million), the Youth Internship Canada Program (1998-99 budget of $105.7 million) and the Social Development Partnerships Program (1998-99 budget of $14.4 million). We invited HRDC to suggest a fourth program for our audit and it identified the headquarters-administered Sectoral Partnerships Initiative (1998-99 budget of $30.4 million).

11.34 Our audit of these four programs built on the Department's internal audit and extended to questions that the internal audit had not covered. We assessed not only the quality and quantity of documentation in the files but also the management of individual projects, issues of program design, and the measurement of project and program results. Moreover, we selected statistical samples of projects from each program in such a way that we would be able, from our review of project files, to project our findings to the program as a whole.

Our audit of four programs built on the Department's internal audit and extended to questions that the internal audit had not covered.

11.35 In addition, our audit assessed the adequacy of corrective actions taken by HRDC in response to its internal audit findings, including the progress it has made and reported. Given that our audit of four programs covered a broader range of issues than the internal audit had examined, we were particularly concerned to assess whether the Department's

Six-Point Action Plan and other initiatives would adequately address the deficiencies we identified.

11.36 Our audit findings on the Action Plan are reported in Part I of the chapter; our detailed audit findings on the four programs we examined are in Part II. Further details on our audit criteria and approach are presented at the end of this chapter in **About the Audit**.

Part I — Observations and Recommendations

Internal Audit Is a Fundamental Tool for Management

11.37 In 1996 we reported that the government was going through a period of tremendous change; departments were being streamlined and restructured in an effort to reduce the administrative cost of government while maintaining or improving the delivery of programs to Canadians. We stressed the importance of effective internal audit in such an environment to help ensure that departmental programs and operations were properly managed.

11.38 Internal audit is responsible for providing senior management with sound information and advice on the adequacy of the organization's internal control systems and on how well they are performing. We expect internal audit to provide risk-based selective coverage of critical areas in a department and to report the findings for senior management's consideration. We expect senior management to direct corrective actions and subsequently to follow up on them.

Past internal audits led to little corrective action

11.39 As we would expect, in 1991 and again in a 1994 follow-up, internal audit advised senior management of internal control weaknesses in the management of grants and contributions. As part of its subsequent assessment of control risks in HRDC, internal audit identified the management of grants and contributions as an area of continuing risk; it followed up with further audit work in 1998 and again in 1999.

11.40 Employment and Immigration Canada formed working groups to address the specific recommendations arising from the 1991 internal audit. However, the efforts of the working groups led to little tangible progress at the local level. The 1994 follow-up report was particularly critical, noting specifically that the recommendations made in 1991 had not been addressed, in whole or in part. We were unable to find evidence that senior management took action to address the findings of the follow-up.

11.41 The Internal Audit Bureau's plans for 1998 defined the management of grants and contributions as a high-risk area, and the Department approved an internal audit of a range of grant and contribution programs. In early 1999, management received the report on the audit of The Atlantic Groundfish Strategy, which identified continuing problems in the management of that contribution program. However, it waited for evidence from the broader audit before taking major corrective action. The 1999 internal audit of grant and contribution programs demonstrated that there were serious and systemic problems in urgent need of corrective action.

11.42 The work of internal audit at HRDC has demonstrated its important role in providing management with assurance about whether control frameworks are effective and operating as designed. It is vitally important that management ensure the continuation of a strong internal audit group that adheres to professional standards. In addition, however, management needs to consider the results of internal audits and ensure that appropriate corrective action is taken.

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The 1999 Internal Audit

Strong evidence of serious and widespread problems

11.43 The Internal Audit Bureau based its work on a sample of 459 project files drawn from some 40 grant and contribution programs in seven general areas (for example, labour market programs and youth employment programs). According to the Department, these files represented approximately $234 million in grants and contributions. The findings of the internal audit were based on a review of the documentation in the files, visits to selected recipients in all regions, and analysis of HRDC's corporate data.

HRDC management acknowledged the range and the seriousness of the identified deficiencies.

11.44 The Department told us that the sample of 459 project files included 38 files erroneously drawn from outside the intended audit population. We concluded that this error in sampling was not material to the findings of the internal audit. The sampling methodology used by the Bureau was not designed (and cannot be used) to project the audit results quantitatively to the full audit universe or to any of its component programs. In other words, the quantitative results reported by the internal audit, such as dollars at risk or numbers of projects where specific controls were not working, apply only to the 459 projects it reviewed.

11.45 Although we did not assess in detail the audit work on individual files, we reviewed the methodology of the audit. In our view, the internal audit provided strong evidence of serious and widespread problems in HRDC's systems and practices for managing grants and contributions. In the files it reviewed, the internal audit found:

- inadequate project selection and approval processes — for example, missing or incomplete documentation in files and failure to carry out certain consultation or verification activities;
- contribution agreements that did not provide an adequate basis for both parties to exercise their rights and responsibilities or for effective financial and operational monitoring by HRDC;
- inadequate monitoring of projects; and
- unacceptable financial management practices — for example, ineffective controls over disbursements, inappropriate coding of transactions, lack of supporting evidence to justify expenses claimed, and lack of compliance with policies on advance payments.

11.46 Management at HRDC accepted the findings of the internal audit. Its initial response, included in the internal audit report, acknowledged the range and the seriousness of the identified deficiencies. It also noted that the lessons learned from the audit had been integrated into a comprehensive action plan for grants and contributions. As part of the plan, each of HRDC's branches, regions and program areas was to develop its own action plan. In addition, a performance tracking group was established to undertake enhanced monitoring and audits so that senior management could receive ongoing assurance about the management of grants and contributions.

11.47 When the internal audit report was released to the public and questions were raised in Parliament about the adequacy of management's response, a new, centrally developed action plan with six main areas of action was announced. The plan included withholding all payments of grants and contributions by the Department until it could be assured that key control requirements had been met. The Six-Point Action Plan was more specific on steps to be taken, timelines, and responsibilities.

Our Audit of Four Programs

We expected to find all projects managed to certain minimum standards

11.48 In our audit of four programs we selected projects that, with few exceptions, had been completed on or before 31 December 1999. This meant that the time period we covered overlapped the period covered by the 1999 internal audit. Our findings apply to approximately $570 million in grant and contribution expenditures in the four audited programs. We audited completed projects so that we could examine the full project life cycle and make an independent assessment of the nature and extent of problems that the Department's corrective action needed to address.

11.49 Our assessments took into account the significant differences in the size and complexity of projects and in the risks associated with them. We did not expect to find the same effort and attention devoted to managing small and simple projects as to managing larger and more complex projects, where financial and performance risks are inevitably greater. However, we did expect to find all projects managed to certain minimum standards, including:

- requests for funding from prospective recipients that indicated how much they were seeking from HRDC, what they intended to do with the funds and what results they planned to achieve;
- defensible and transparent application of project eligibility and selection criteria in recommending projects for approval;
- approvals by appropriate authorities of the funding to be provided;
- signed contribution agreements that set out clearly the terms and conditions of the funding and provided a basis for each party to exercise its responsibilities;
- effective financial controls, including compliance with relevant authorities and financial monitoring of projects;
- adherence to the terms and conditions of the agreement, with formal changes to them if required; and
- monitoring of project activities and results to provide a basis for learning as well as for accountability.

11.50 In our view, observing these standards in managing projects is not optional. However, we did expect that attention to them would vary significantly, depending on the circumstances. For example, a simple letter from a prospective recipient might be fully adequate as an application for a straightforward project that involves a small contribution, whereas an application for a large, complex project would require a detailed proposal.

We expected that attention to standards in managing projects would vary significantly, depending on the circumstances.

11.51 Our expectations for the management of grants and contributions are consistent with the Treasury Board's recently revised Policy on Transfer Payments. The revised policy consolidated a number of existing policies and provided greater clarity on issues of financial management and control and on the delivery of programs by third parties. The Treasury Board policy in effect during the period covered by our audit was less clear.

Our audit confirmed and extended the findings of the 1999 internal audit

11.52 Our audit of four programs confirmed and extended the findings of the 1999 internal audit. We found a widespread lack of due regard to probity in spending public funds and to achieving desired results. Several practices in the four programs we examined were unacceptable. These included lack of adherence to program terms and conditions, inadequate project selection processes, breaches of authority, payments made improperly, and inadequate monitoring.

For projects prior to January 2000, we found a widespread lack of due regard to probity in spending public funds and to achieving desired results.

11.53 We were particularly concerned about the pervasiveness of the deficiencies we found. Although the specifics varied across programs, our audit showed serious problems in all key areas of all four programs we audited.

11.54 In 81 of the files we reviewed, we found information that raised questions about the appropriateness of some payments. We provided this information to the Department. It initiated a review of all these cases to determine whether overpayments had been made. At the time we completed our audit report, the Department had completed its review of most of these cases, and had identified some overpayments. In a small number of cases, the Department had not completed its review.

11.55 In addition to auditing the management of individual grant or contribution projects, we examined other aspects of the four programs. We expected each program to have the following:

- a rationale for the choice of funding instrument (grant or contribution);
- clear and measurable program objectives;
- clearly defined criteria for project eligibility and selection, consistent with program objectives;
- capacity to deliver the program, including resources and clearly defined procedures, roles and responsibilities;
- open and effective communication to make potential applicants aware of the program; and
- measurement and reporting of program results.

11.56 We found several weaknesses in the design of the four programs we audited and in the measurement and reporting of program results. Part II of this chapter provides more detailed information on the four programs and what we found.

In response to the findings of its internal audit, in February 2000 the Department put in place a Six-Point Action Plan.

Progress in Implementing the Action Plan

The Six-Point Action Plan

11.57 In response to the findings of its internal audit, in February 2000 the Department put in place a Six-Point Action Plan, designed to strengthen the administration of grants and contributions and to rectify the problems identified by the audit. Exhibit 11.2 provides an overview of the Action Plan.

11.58 In a letter dated 7 February 2000, the Auditor General indicated that in his opinion the proposed Action Plan represented a thorough approach to corrective action on the more immediate control problems identified by the internal audit. The letter also noted that the Plan included some longer-term actions that strengthened the approach. In the current audit, we assessed the Department's progress in implementing the Six-Point Action Plan. We also looked at whether the Plan and other initiatives of the Department and the government would address our findings on the four programs we audited.

Current management is committed to taking corrective action

11.59 In an effort to respond to the issues raised by the internal audit and the

Exhibit 11.2

The Six-Point Action Plan

Areas of focus	Short-term action	Longer-term action	Supporting action
1. Ensure that payments meet financial and program requirements.	✓		
2. Check and correct problem files, including the 37 identified by the audit as being of potential concern.	✓		
3. Equip and support staff with the necessary tools, training and resources.		✓	
4. Ensure that staff better understand their accountability for grants and contributions.		✓	
5. Get the best advice available.			✓
6. Report progress regularly to public and staff.			✓

Source: Human Resources Development Canada questions raised in Parliament, HRDC committed significant management and staff resources to implementing the Action Plan. Specific milestones were set out, including a commitment to review all active files by 30 April 2000 for compliance with program and financial criteria, to implement regular performance tracking of grants and contributions starting in February 2000, and to report publicly on progress each quarter, starting in May 2000. The Department created a Grants and Contributions Co-ordinating Team, headed by the Senior Assistant Deputy Minister, to lead the implementation of the Action Plan. The team comprises national, regional and local representatives.

11.60 Developing and implementing the Action Plan required a significant amount of time and the commitment of HRDC management and staff. For example, project officers for the Canada Jobs Fund told us that meeting the commitments to review and revise existing project files meant putting applications on hold until the file review was over. The extended wait for approval caused enough problems for some project proponents that they withdrew their applications.

Commitments in the Action Plan are being met

11.61 The Department has generally respected the timetable it provided. It has made progress in improving and tracking the extent to which payments meet financial and program requirements. Problem files have been checked and corrected. Management has communicated regularly with staff and has provided public reports on progress.

11.62 A number of the longer-term actions in the Plan are under way, such as providing staff with the necessary training and tools and ensuring accountability for results. An independent review by a consulting firm also concluded, "HRDC has made significant progress in implementing the Six-Point Action Plan."

Performance Tracking Directorate is established and operational

11.63 In response to a draft of the internal audit report, in November 1999 HRDC established a Performance Tracking Directorate, originally as part of the Internal Audit Bureau. In May 2000 the Directorate was transferred to the Director General, Accounting Operations. With a staff of 23 and a budget of $2.7 million, the Directorate has become an important means for continuous monitoring of the extent and impact of corrective action.

11.64 The Performance Tracking Directorate is designed to act as a quality control by measuring improvement in the administration of grants and contributions. We reviewed the sampling methodology used by the Directorate to draw a national sample of files for review, and we found that it was sound.

11.65 Given that a major component of the Action Plan's first step was the tracking of performance, regular monitoring carried out by the Performance Tracking Directorate represents good progress. If properly implemented, it should give management an ongoing measure of performance in the management and control of grants and contributions.

If properly implemented, the Performance Tracking Directorate's work should give management an ongoing measure of performance in the management and control of grants and contributions.

The Department reviewed all 17,000 active files

11.66 The Department committed itself to reviewing all active files to ensure that payments meet program and financial criteria, and it committed to taking any corrective action required. Headquarters and some regions developed checklists for use by staff in reviewing active files. Our assessment indicates that the direction the Department provided to staff on how to deal with active files complies with the requirements of the *Financial Administration Act* and with the Treasury

Board's Policy on Transfer Payments. In addition, the checklists covered the major areas of concern our audit identified. However, we did not assess how well the checklists were applied. Based on a review of a non-representative sample of 76 files, management concluded that directives had been adequately implemented.

11.67 The Department concluded its review of 17,000 active files on 30 April 2000, as scheduled, and presented the results in a May 2000 progress report on the Action Plan. The Department reported that 16 files needed adjustments in amounts that exceeded 25 percent of the contribution agreement value, and that six overpayments totalling $3,229 had been identified.

There is a higher likelihood of finding overpayments in closed files than active files, as our audit of four programs showed.

11.68 It is not surprising that the review found so few overpayments. Only active files were reviewed and since, by definition, active files can still be adjusted, the review could not be expected to identify many overpayments. There is a higher likelihood of finding overpayments in closed files, as our audit of four programs showed.

The Department has started to report on progress

11.69 The Department's May 2000 progress report on the Action Plan indicated that the Performance Tracking Directorate had examined a sample of 76 files to confirm that the review of active files was being carried out properly. According to the report, the examination showed that all files had been reviewed in response to HRDC's national directive, and that all payments made after 20 January 2000 met the five essential financial criteria outlined in the directive (see Exhibit 11.3). These criteria are consistent with the *Financial Administration Act* and Treasury Board policy provisions that require certification by authorized officials of eligibility or entitlement to payment.

Exhibit 11.3

Five Essential Criteria for Payments

1. **A signed contribution agreement that meets the Treasury Board's terms and conditions for the program.**
2. **The delegated financial signing authorities sign the agreement and approve payments.**
3. **The Treasury Board's policy and guidelines for advance payments followed.**
4. **Claim forms and supporting documentation received from sponsors/payees.**
5. **Expense claims reviewed and certified to be allowable under the contribution agreement and the program's terms and conditions.**

Source: Human Resources Development Canada

11.70 The report concluded that the directives on reviewing active files issued under the Six-Point Action Plan had been implemented adequately and were having a positive impact on the management and administration of grants and contributions. We note, however, that HRDC's review of 76 sampled files was not sufficient to determine whether all 17,000 active files fully met program requirements and file management standards.

11.71 An August 2000 progress report by the Performance Tracking Directorate indicated that the administration of active files has shown a substantial improvement over the findings of the internal audit. It indicated that in projects started between 1 February and 31 March 2000, there was a high level of compliance with departmental directives and guidelines relating to project applications, contracting, recommendations and approvals.

11.72 We looked at the methodology used to review the files for the August 2000 progress report and found a much wider range of issues tracked than had been covered in the 1999 internal audit — a range that corresponds more closely to our audit of the four programs reported in Part II of this chapter.

11.73 The August 2000 progress report was the first of four that the Directorate plans to prepare each year. Future reports will be able to provide a fuller assessment

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11.71 An August 2000 progress report by the Performance Tracking Directorate indicated that the administration of active files has shown a substantial improvement over the findings of the internal audit. It indicated that in projects started between 1 February and 31 March 2000, there was a high level of compliance with departmental directives and guidelines relating to project applications, contracting, recommendations and approvals.

11.72 We looked at the methodology used to review the files for the August 2000 progress report and found a much wider range of issues tracked than had been covered in the 1999 internal audit — a range that corresponds more closely to our audit of the four programs reported in Part II of this chapter.

11.73 The August 2000 progress report was the first of four that the Directorate plans to prepare each year. Future reports will be able to provide a fuller assessment of a project's life cycle, including financial management.

The Department identified 37 projects for further follow-up

11.74 HRDC's review of 37 projects flagged for further analysis and correction was a major item in the action step "to check and correct problem files." The internal audit had identified 35 of the projects from the 459 projects it sampled; two others originated outside the audit sample. The purpose of the review was to complete the investigation where the initial audit work showed that financial rules might have been broken (for example, where overpayments may have occurred), as a basis for any necessary corrective action.

11.75 Work began in December 1999, although most of it took place during February 2000. The review of the 37 projects, fuelled by discussion in the media and in Parliament about the nature and extent of the problems associated with them, took on an importance well beyond what HRDC had foreseen when it first identified a need for additional work. The Department came under great pressure to conduct the follow-up review to a very high standard in a short time frame.

11.76 The Department created a task force of senior officers from its Financial and Administrative Services Branch to assess the outcome of the review. The task force signed off on the results when the follow-up work was completed. The March 2000 report, published on the Internet and provided to the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, showed accounting errors across fiscal years, adjustments needed to active files, and overpayments; it also provided, for each project, a summary of the other review outcomes. Our audit confirmed that the Department made adjustments and took steps to recover the overpayments.

The review illustrated poor administrative practices and their consequences

11.77 The Department's review confirmed that poor administrative practices made it difficult to audit payments and to determine whether there had been overpayments. Program staff often made informal arrangements with sponsors that were not reflected in formal amendments to written agreements. Some of these informal arrangements were documented; others were agreed to orally or even implicitly. Some of the arrangements were contrary to the conditions established in the written agreement or to departmental and Treasury Board policies. While not acceptable practice from a government perspective, these types of arrangements have legal standing. As well, the review found that some of the formal contribution agreements were poorly constructed. For example, key clauses were missing or ambiguous and negotiated rates, rather than actual costs, were used without a clear basis. This made it difficult to determine whether the negotiated rates included ineligible costs, particularly profits.

The review of the 37 projects took on an importance well beyond what HRDC had foreseen when it first identified a need for additional work.

11.78 Other departmental actions also affected the ability of reviewers to identify overpayments. For example, the Department allowed payments for expenses incurred outside the established funding period, through retroactive amendments to agreements that were already closed or through informal written or oral arrangements with the sponsor. Other examples of inappropriate practices included allowing expenses that were ineligible according to the contribution agreement or Treasury Board policy. As well, officers allowed sponsors to apply interest income earned from inappropriately large advances to increase the scope of project activities — but without a formal amendment to the agreement to increase the dollar value.

Overpayments can be established only when the Department can show that the sponsor did not fulfil its obligations as specified in the contribution agreement.

11.79 Overpayments can be established only when the Department can show that the sponsor did not fulfil its obligations as specified in the contribution agreement. The review showed that the Departments officials had ignored or not complied with internal controls, including the terms and conditions of contribution agreements. Payments made in accordance with arrangements agreed to by HRDC officials cannot subsequently be established as overpayments. Such arrangements, no matter how ad hoc, become part of the Crown's contractual obligations.

11.80 As a result, the Department's review identified and reported as overpayments only those cases it considered attributable to the actions of a sponsor. HRDC reported that it had identified $226,369.51 in overpayments, out of the $33 million in payments made to the 37 projects. One project alone accounted for $220,000 of that amount.

HRDC lost a valuable opportunity to provide concrete examples of the consequences of oral agreements, retroactive amendments to agreements, inappropriately large advances at year-end, allowing claims for ineligible expenses, poorly constructed agreements and other similar practices.

11.81 The Department's work on each of the 37 projects called for a full review of financial claims in relation to the terms and conditions of the contribution agreement. We concluded that there were some inconsistencies in the approach taken to the review, which limited our assurance that all issues were identified in individual projects. For example, the extent and quality of supporting documentation and working papers was thorough in some cases but limited in others. Some reviews provided no indication that the project had been assessed for interest earned on advances. HRDC's documentation indicated that in most cases all claims had been reviewed; but in a few large projects not all claims or expenses were tested.

Reporting on 37 problem projects focussed on overpayments

11.82 Parliamentarians and the media expressed a strong interest in the nature and extent of the problems in the 37 reviewed projects. Public information provided on the review in March 2000 and in the May 2000 Progress Report on the Six-Point Action Plan focussed largely on the overpayments the Department had been able to identify.

11.83 HRDC provided little public information on the nature of the administrative problems it found in the review of the 37 projects and on their consequences. The Department believed that the 1999 internal audit report had sufficiently covered the poor administrative practices found in the follow-up review of the 37 projects and that the Six-Point Action Plan had further addressed these deficiencies. It also believed that the major public concern with the 37 projects was whether or not overpayments had been made.

11.84 The administrative problems in the 37 projects identified in the Department's review confirmed and elaborated the 1999 internal audit findings. They illustrated the extent to which the system of internal controls and accountabilities had broken down, placing public funds at risk. In our view, HRDC lost a valuable opportunity to provide concrete examples of the consequences of oral agreements, retroactive amendments to agreements, inappropriately large advances at year-end, allowing claims for ineligible expenses, poorly constructed agreements and other similar practices. As a consequence, among others, the Department was unable to determine overpayments in most cases. The key deficiencies have been addressed in the Action Plan. Reporting such additional information about the problems in the 37 files would have been helpful to the public and parliamentarians as they sought to understand the issues facing HRDC and to assess the adequacy of its Action Plan and other corrective measures.

The Department is planning to review dormant files, but results are not yet available

11.85 As part of the Six-Point Action Plan, the Department will assess dormant files. These are files of projects that were active during 1998-99 or 1999-2000 but are now closed. The Department has selected a sample of dormant files, based on a set of risk factors. The results of the Department's review of dormant files were not available when we completed our audit work. However, our audit of four programs indicates that dormant files could contain a variety of problems, including overpayments that need to be recovered.

Corrective actions go beyond the Six-Point Action Plan

11.86 The Department had undertaken several initiatives before the announcement of the Six-Point Action Plan. These included establishing the Performance Tracking Directorate as well as a number of working groups to deal with specific problem areas identified in the internal audit report. The Department has since put in place other initiatives for broader corrective action needed. For example, it is examining the objectives of grant and contribution programs. It has also made organizational changes following an examination of accountability arrangements.

11.87 In addition to initiatives taken by HRDC, it is worth noting that in June 2000 the Treasury Board made changes to its Policy on Transfer Payments. The changes clarify many aspects of the previous policy. Among many new measures, the policy now requires that departments put results-based accountability frameworks in place for grant and contribution programs. It also requires departments to ensure that due diligence is exercised in making grants and contributions. Departments are expected to report on program objectives, expected results and outcomes in their report on plans and priorities. The Treasury Board will approve program terms and conditions for a specified period, usually up to five years. Departments must formally evaluate and report on the effectiveness of a program when requesting that the terms and conditions be renewed. Further, in spelling out its function as a management board the Treasury Board has indicated that it is strengthening its monitoring role.

Our audit showed problems beyond the scope of the 1999 internal audit

11.88 Our program audits identified many problems, some of which are the same as those identified by the internal audit. Others are in areas beyond the scope of the internal audit. We noted problems in:

- translating the general social policy purposes into operational terms, stated as either objectives or eligibility criteria. We also noted problems in stating the expected results of programs in clear and measurable terms;
- using project results and program evaluations to make necessary changes and modifications (managing for results);
- providing the public with information about the availability and characteristics of a program to promote equal access;
- properly managing and controlling projects — including project selection and approval as well as financial management and control; and
- providing adequate support (resources, training, guidance and tools) for program delivery.

11.89 We assessed HRDC's Six-Point Action Plan and other initiatives to determine whether they address these problems.

Need to improve the way general social policy purposes are operationalized

11.90 HRDC is a social policy department that delivers a wide range of programs and services to assist Canadians of all ages, including those with distinct needs. Its mission is to enable Canadians to participate fully in the workplace and the community. General policy direction is laid out by government and approved by Parliament in the form of legislation. An essential step in improving the management of grant and contribution programs is to ensure that the design of the program, as reflected in terms and conditions approved by the Treasury Board and operationalized by the Department, reflects the policy intent.

11.91 As our audit of four programs found, this involves turning difficult concepts like sustainability, the building of community capacity, and learning systems into concrete, deliverable programs. It is particularly challenging to program designers when views differ on the best approach and when needs vary across regions. Nonetheless, the obligation remains to clarify what is to be achieved so the program can be structured to support this expectation.

Officers responsible for implementing programs and projects need to know what is to be delivered to whom, and how.

11.92 Officers responsible for implementing programs and projects need to know what is to be delivered to whom, and how. In grant and contribution programs, this means clearly articulating the program's objectives or criteria, setting out measurable results to be achieved, and accompanying this with appropriate training and guidance to staff. Project officers then have clear direction on which to take concrete action.

11.93 We recognize the need for some flexibility to allow programs to respond to local realities. In our view, however, all four of the programs we audited suffered from undue lack of precision in the statement of program objectives or criteria and in the accompanying guidance. For example, in the Youth Internship Canada program the eligibility criteria for participants (unemployed or underemployed, normally aged 15 to 30, and legally entitled to work in Canada) were subject to varying interpretations. No guidance had been made available to staff to help ensure that they applied the criteria consistently. Further, the objectives and eligibility criteria for the Social Development Partnership program were stated in broad terms and were not always clearly defined.

11.94 The Department told us that it is developing additional program guidelines and additional training to help staff establish an appropriate balance between precision and flexibility. For example, the Youth Initiatives Directorate recently developed and communicated criteria for defining youth at risk and is expanding existing program guidelines.

11.95 Two of the four programs, Youth Internship Canada and Transitional Jobs Fund/Canada Jobs Fund (TJF/CJF) had defined indicators of results. In TJF/CJF, the measurement of results was built into the program design but reliable information on results was not produced as intended. Performance indicators were not defined for the other two programs. If a program's design or subsequent operational guidance is not clear about what the program is to achieve, the proper focus of the program's expenditures is subject to wide interpretation.

Plans developed to clarify program intent

11.96 The Six-Point Action Plan does not deal with the need to clarify program design and policy concepts. However, HRDC management has recognized the need and initiated a study of program management to identify the action that is needed. The study includes an examination of program mandates, objectives, design, implementation, monitoring, and areas for program and policy redesign.

11.97 The objectives of the study also include ensuring that all programs manage for results, improving learning within and across programs, and strengthening the linkages between policy development and program design. At the time of our audit, the Department was expecting to complete assessments of all its grant and contribution programs by fall 2000, with identified strategies for strengthening program management. The Department was also planning to develop appropriate performance measures as part of that exercise.

11.98 By 31 March 2001, all programs are to have results-based accountability frameworks in place. All programs are also to have learning plans that outline mechanisms for ongoing learning, dialogue and redesign, including an integrated audit and evaluation cycle. The Department has indicated that it will obtain official Treasury Board approvals by December 2002 to change program terms and conditions — well before the Treasury Board's deadline of March 2005.

11.99 As one element of the program management study, a number of programs, including the four we audited, have produced summaries of program management issues along with key elements of their action plans. The process of developing these summaries included self-assessment supplemented by peer review and discussions with the regions. In initial pilot documents we received, some managers identified a need for improvement in areas similar to those we noted in our audit. For example, managers of the Social Development Partnerships program concluded, as we did, that objectives need to be refined, measurable outcomes defined and the processes for decision making and review improved. Managers of the Sectoral Partnerships Initiative concluded that performance measures need to be validated and refined, and that program policy and guidelines need to be updated.

Improvement required in managing grants and contributions for results

11.100 Managing for results requires more than measuring results through ongoing performance measurement and periodic evaluation. It also requires using information on results to make changes to the programs and to report on their performance. As the new Treasury Board policy on transfer payments recognizes, a focus on results in grant and contribution programs provides direction on who should receive funding, whether projects are meeting expectations, and how successful the program is overall.

As part of a program management study, some managers identified a need for improvements in program design similar to those we noted in our audit.

11.101 We expected staff in all four programs we audited to have clearly defined the results that approved projects were to achieve. We found that expected results and the related information requirements were not defined consistently. Nor did stipulating that the information was required lead to its systematic collection — even when, as in the case of TJF/CJF, the contribution agreements required the project sponsors to report on results. In the Youth Internship Canada program, expected results were defined but the information on actual project results was limited. Desired results of projects in the Social Development Partnerships and the Sectoral Partnerships Initiative programs were not defined clearly.

Three of the four programs we audited had undergone some evaluation, and an evaluation of the fourth is planned.

11.102 Three of the four programs we audited had undergone some evaluation, and an evaluation of the fourth, Social Development Partnerships, is planned. A preliminary evaluation of the TJF was carried out early in the program and several key questions were left to be answered later, in a full evaluation planned for 2000. That evaluation did not proceed. The evaluation of the Youth Internship Canada program had just been completed at the end of our audit.

11.103 We found that the work was sound in the evaluations of the Youth Internship Canada and the Sectoral Partnerships Initiative programs. We noted that some program changes were made as a result of the November 1997 evaluation of the Sectoral Partnerships Initiative and the 1998 Transitional Jobs Fund evaluation.

11.104 As we have noted, the objectives of the Department's program management study include developing appropriate performance measures and strengthening managing for results. However, as demonstrated by work we have done in other areas of government, achieving these objectives will require strong leadership from management and continuous effort.

Need to ensure equal access to programs

11.105 Public servants are expected to provide services equitably and fairly to Canadians, whether a service or program is directed to the whole population or to a specific group. Part of providing equitable access is ensuring that good information about a program is available and accessible to those who potentially qualify to participate.

In our view, the methods used to promote the four programs we audited did not always ensure that potential applicants had equal access to them.

11.106 Our audit of four programs found that some information on all of them was available and disseminated through a variety of media. In addition, the programs relied to varying degrees on networks and contacts maintained by project officers. In some cases, programs funded the same project sponsors year after year as part of a longer-term intervention. In our view, the methods used to promote these programs did not always ensure that potential applicants had equal access to them. Moreover, evaluations of the programs have not paid enough attention to assessing whether they have been promoted effectively and whether eligible Canadians are aware of the programs and their characteristics.

11.107 In its June 2000 report, the Standing Committee on Human Resources Development and the Status of Persons with Disabilities recommended that the Department ensure that eligibility criteria for all its grant and contribution programs were clearly identified, adequately communicated and applied equitably across the country. The Committee also recommended that to promote transparency, HRDC ensure that information available on its Web site provide the public with details about individual grant and contribution programs.

11.108 The Six-Point Action Plan itself makes no reference to equality of access to grant and contribution programs. However, the Department addressed this issue in its response to the Standing Committee. It indicated that by the end of 2000, information about all programs and their eligibility criteria would be available on its Web site and in all local offices. Local offices will provide the information to all members of Parliament before the end of the year. In addition, the Department has indicated that it will ensure that the information is kept up to date.

Need to improve the management and control of projects

11.109 Parliament sets the general purposes of expenditures and the limits on them, and the government provides public servants with further guidance on the mechanisms to be used to meet these requirements. For a grant and contribution program, Parliament establishes the program purpose and broad financial management framework, and appropriates funds or authorizes the use of funds from other sources.

11.110 Government, through the Treasury Board, approves the specific terms and conditions that programs are to observe and provides guidance on managing grants and contributions and controlling the disbursement of funds. As past internal audits and our own audit of four programs have shown, HRDC's management and control of projects and its disbursement of funds to them have been weak. The Department's response to the internal audit focussed, along with its Six-Point Action Plan, on immediate corrective action to address these weaknesses.

11.111 We found that there were problems in meeting the requirements of section 34 of the *Financial Administration Act,* which requires an official with the appropriate signing authority to certify eligibility and entitlement to payment. Our audit of the four programs found that staff without the appropriate delegated authority were frequently approving payments under section 34, and often did not review appropriate information to support claims.

11.112 In January 2000, HRDC stopped all payments until managers could be assured that five essential financial criteria had been met for each project (see Exhibit 11.3). In addition, the Department eliminated a problem that internal audit had identified — namely, poorly controlled codes for access to the financial system. The Department recognized that it needed to move from these immediate actions to building corrective measures into the management of all grants and contributions.

Steps taken to improve project selection and approval

11.113 Our audit of four programs found that each had problems in managing the selection and approval of projects. As already noted, some of the problems were due to a lack of clarity on what the projects were to achieve. Even allowing for these difficulties, however, we found many cases with no record of the basis for the project's selection or of who had been responsible for recommending the expenditure.

11.114 As part of improving financial management and control, the Department has taken steps to provide guidance and direction on the kinds of documentation and review of projects that it expects. If properly implemented and supported by tools and training, these steps should lead to significant improvement.

Actions in place to address problems in financial management and control

11.115 Our audit of four programs identified several problems with financial management and control. They included weaknesses in the contribution agreements, amendments made without a supporting rationale, payments made for ineligible costs and expenses, payments made without claims having been submitted, improper advance payments, inconsistent treatment of shared costs, and payments approved without the necessary authority. Details of these findings, by individual program, are in Part II of this chapter.

11.116 Part of the Department's commitment in the Six-Point Action Plan was to review all active files (see paragraph 11.66) for compliance with program and financial criteria and to take corrective action as required. The checklists used to review the active files covered the immediate areas of concern, including whether the projects met program terms and conditions.

In January 2000, HRDC stopped all payments until managers could be assured that five essential financial criteria had been met for each project.

Appropriate action taken to equip and support staff

11.117 As part of the Action Plan, the Department has undertaken a series of specific initiatives to equip and support staff in their work. Based on an assessment of workload, staff capacity and the views and concerns of staff, program staff will be given clear direction, tools, training and resources. We believe these initiatives will help address the shortcomings that our audit and the 1999 internal audit identified in the management of grants and contributions.

11.118 Among the tools HRDC is developing is a model file to replace the use of checklists. The model file contains instructions and forms to guide staff in all key aspects of financial and project management, including the aspects where our audit found deficiencies. For example, the model file offers guidance on how to identify high-risk files that require more monitoring. Staff were directed to start using the model file in September 2000.

11.119 HRDC is also developing an operational manual and policies for grants and contributions. These will provide particular guidance on financial management and control requirements. The manuals and policies will fill an important gap created in the mid-1990s, when several volumes of departmental manuals and procedural directives were replaced with only brief guidance.

The Department is developing a new control framework with three levels of control points, a quality assurance framework, and a more consistent organizational structure.

11.120 To support the Action Plan, the Department is developing a new control framework with three levels of control points, a quality assurance framework, and a more consistent organizational structure at the regional and local levels. This control framework will also provide for direct oversight and will make specialist advice available to field staff handling grants and contributions. In addition, higher-level staff will handle the more complex files.

11.121 The control framework has built-in quality assurance practices. It calls for all projects to be reviewed by higher-level staff in local offices and for a small percentage of files at the regional level to be subject to post-audit. At the national level, the Performance Tracking Directorate will review between one and two percent of files. The control framework also envisions a feedback loop so that results will be used to highlight inconsistencies and procedural problems at the local level as a means to determine training needs.

11.122 The policy the Department proposes for training provides for mandatory training of managers and program staff. Program delivery training for staff addresses, for example, assessment of project proposals, contracting, payments, financial and activity monitoring, and follow-up.

11.123 We believe that when implemented in the field, the new tools and concepts being developed will go a long way toward addressing the concerns of staff, as well as those identified in our audit. However, much work on implementation remains to be done. Management will need to sustain the strong support it has shown thus far to ensure that adequate resources are obtained and that staff are trained and supported in applying the new tools, methods and approaches. As well, follow-up will be needed to ensure that staff take the training and gain the required knowledge.

More work required to determine the resources needed for program delivery

11.124 The resources required to deliver grant and contribution programs properly will vary, depending on the complexity and size of the program and the risks associated with it. Management is responsible for ensuring that the appropriate capacity is in place to deliver each program. This includes having enough staff with the necessary skills, and providing the tools, the support, the training and the information systems that they need. The Six-Point Action Plan specifically addressed the need to equip and support staff. However, the Department has identified a need for additional resources in other areas.

11.125 As indicated by our audit of the four programs and by the Department's own consultations with staff, questions remain about the adequacy of the resources (both program staff and administrative support staff) available to deliver grant and contribution programs. For example, staff told us that the requirements for monitoring (which frequently were not met) demanded too much of their time, given the other work expected of them.

11.126 Staff cuts in the 1990s had an impact on the Department's capacity to deliver programs. Nevertheless, HRDC management proceeded with the Transitional Jobs Fund without receiving any new operating funds. Staff involved in delivering the TJF faced not only additional work but also work requiring additional skills that many lacked.

11.127 The Grants and Contributions Steering Committee considered the evaluation of capacity as part of the Action Plan. It recognized that the Department's capacity to undertake grant and contribution programs had not been clearly identified. HRDC agreed with the Treasury Board Secretariat that it would undertake a workload analysis, which was under way when we completed our audit. Staff had started to identify annual workload in terms of the number and characteristics of projects administered. As an interim measure, HRDC has reallocated $20 million internally and the Treasury Board has approved a reallocation of a further $30 million from within HRDC's existing budget to strengthen its delivery of grant and contribution programs.

HRDC agreed with the Treasury Board Secretariat that it would undertake a workload analysis. This was under way when we completed our audit.

11.128 HRDC delivers a range of programs using grants and contributions, as do other departments. Benchmarking the resources required to deliver different types of grant and contribution programs will provide a valuable tool for government managers and central agencies to assess the adequacy of program resources.

Information systems need an overhaul

11.129 The internal audit identified deficiencies in the capacity of information systems to provide timely performance information (financial and non-financial). They included difficulty in obtaining information on sponsors' current and past projects with HRDC and the status of advances and expenses claimed. Corrective action on these deficiencies is part of the Six-Point Action Plan. A concept paper was prepared and a firm plan was to be ready by October 2000. HRDC has requested additional funding over the next three years to develop a new information system.

11.130 As a short-term solution, HRDC is upgrading an existing system to make information on grants and contributions available from one system rather than many. This interim measure was to be in place in fall 2000. It is a short-term solution, however, and will not fully address the information needs of managers at the program level. But it will create a single warehouse of data on grants and contributions and will improve the Department's capacity for external reporting.

11.131 The proposed new information system to be delivered in phases over the next three years is still at the concept stage. For maximum usefulness to management, it needs to be integrated with the financial system in a way that makes it possible for users at different levels in the Department to obtain basic financial information on contribution agreements. Managers and project officers need to be able to obtain information readily on how much has been paid to a project and on what financial commitments remain. The new system's features related to performance information were the least developed at the time of our audit.

The proposed new information system to be delivered in phases over the next three years is still at the concept stage.

Program Accountability

11.132 By design, and given the often general objectives and broadly stated terms and conditions, the programs we audited left public servants a great deal of discretion to determine a proposal's value and judge its eligibility. Treasury Board, a Cabinet committee of ministers, sets the eligibility requirements that departments are expected to spell out in their own guidelines and approval processes. Further, Canadians eligible for public programs expect to have equal access to them. Traditionally, public servants are responsible for administrative matters on behalf of a minister and answer to the minister.

11.133 Our work raised two issues related to management accountability and responsibility. The first concerns the role of members of Parliament and ministers; the second concerns the responsibility and accountability of staff for program decisions they make.

To deliver programs in a decentralized environment requires clear direction on what is expected as well as regular monitoring and reporting of performance.

The role of elected officials

11.134 Elected officials outside of the executive branch of government usually do not have a direct role in program delivery. In the case of the Transitional Jobs Fund and the Canada Jobs Fund, program guidelines required that each project have a written recommendation from the member of Parliament for the area as one of the inputs for the project approval process. Such involvement in the decision-making process confuses traditional accountability relationships. The Standing Committee on Human Resources Development and the Status of Person with Disabilities noted, "Direct political involvement in HRDC's project selection process can potentially create a conflict for Parliamentarians, whose role is to hold the government accountable." The Committee concluded that the role of members of Parliament in the project selection process should remain an advisory one.

11.135 As described in Part II of this chapter, in our audit of four programs it was sometimes difficult to determine the basis on which a project had been selected. Because we reviewed only projects that had been approved, we did not review evidence that would indicate a role that members of Parliament played in decisions to reject any TJF or CJF proposals.

11.136 We found cases where project approvals were not based on the procedures established for decision making — namely, that public servants make a recommendation and ministers make a decision. Some of the projects were not eligible for the program under which they were approved; others were eligible but had not been evaluated against other projects. The credibility of established processes is weakened if they are not followed.

Steps to strengthen management accountability

11.137 HRDC is a decentralized department whose delivery of most of its programs is delegated to local and regional offices. Despite this delegation, the Deputy Minister remains responsible for the administration of the Department and, in turn, is responsible to the Minister. To deliver programs in this environment requires clear direction on what is expected as well as regular monitoring and reporting of performance. Decentralized structures require strong, clear lines of accountability to work effectively and not the type of program delivery found, for example, in the Transitional Jobs Fund. There, delivery was fully delegated and there was little central monitoring to ensure the consistent application of, and compliance with, the program's terms and conditions.

11.138 If senior management in the Department is to effectively meet its commitments to change, management structures and lines of accountability must be clear. The Department undertook an accountability review of its management structure and developed a new organizational model for the delivery of grants and contributions. Both initiatives clarify responsibilities and strengthen accountability relationships.

11.139 The aim of the Department's new organizational model is to have consistent support for project officers in all major Human Resource Centres of Canada. Three key positions have been identified. A program consultant will be responsible for technical advice, training, and quality assurance at the local level. A senior development officer will be responsible for complex cases and also for strategic development in the delivery of grants and contributions. Finally, project officers will continue to administer projects. Documentation and systems support will be provided by clerical staff. This model responds in part to concerns about the need for adequately trained and supervised staff to manage grant and contribution programs. The Department has begun staffing actions.

11.140 With appropriate staffing under the new model, project officers will be better able to meet financial and program requirements because they will be able to rely on consistent administrative support as well as advice from higher-level specialists. Segregation of duties will be improved by ensuring that enough staff are available to carry out the separate tasks.

11.141 The Department has also conducted a review of its management accountabilities, with input from 70 senior executives and managers and an External Advisory Committee (including central agency representatives and selected deputy ministers of other departments). It has also obtained assistance from external consultants. The process culminated in a memorandum to the members of the executive committee (Management Board) from the Deputy Minister, setting out a new regime to clarify and improve accountability structures.

11.142 The memorandum identified the following actions as central to increasing the clarity of decision making and accountabilities in the organization:

- developing and implementing national protocols that clarify the authority, responsibility and accountability of the policy, program, corporate service and regional heads;
- creating focal points of contact in the Deputy Minister's office along program development, service delivery and corporate service lines; and
- establishing an executive management committee and four key departmental committees with clearly defined authorities.

Work on developing and implementing these actions has begun. These actions are in addition to the earlier reorganization of the branch administering grant and contribution programs, which established separate responsibilities for regional and national programs.

Sustained effort will be needed

11.143 As the results of previous audits demonstrate, over a number of years an unsatisfactory approach to the management of grants and contributions had developed in the Department and become widespread. Inappropriate practices had become the routine, accepted by management and supported by the absence of strong systems and controls. Practices that develop over many years frequently become entrenched.

The Department set out a new regime to clarify and improve accountability structures.

11.144 The Department's current management is committed to implementing corrective action. It took a number of immediate steps that sent staff a clear message that change was expected. However, changes need to address the fundamental problems. The Department's internal audit, its subsequent review of 37 problem files, and our audit of four programs all revealed the extent to which the system of internal controls and accountabilities had broken down, placing public funds at risk.

11.145 The Department has begun a number of actions committed to in its Six-Point Action Plan, such as providing training and improving staff understanding. But it will need to sustain its efforts and commitment if it is to produce the desired change. Staff will need support as they change their approach to internal controls, especially as they deliver programs increasingly through third parties.

11.146 Management will need to continue monitoring the progress of corrective actions and the results achieved. The performance tracking system the Department has developed to monitor progress is an innovative approach to ongoing performance measurement. If applied systematically, it should give management a good measure of the progress being made.

The steps to implement the Action Plan form part of the basic performance agreements for 2000-01.

11.147 As part of the incentive system for managers, their performance agreements will include commitments to improving the management of grants and contributions. The steps to implement the Action Plan form part of the basic performance agreements for 2000–01 between the Deputy Minister and all executives and managers involved in grant and contribution programs. The deadline for establishing related goals in the accountability accords was 31 August 2000.

11.148 The Department has set a clear agenda for management action in its numerous plans and initiatives. It needs to sustain the momentum that has developed. In particular, to change the way it manages grants and contributions, the Department will need to ensure that staff have a common and consistent understanding of the fundamentals of control. During the course of our work, we identified the following areas that require additional attention.

11.149 The Department should put in place quality control measures to review corrective actions, and ongoing monitoring to ensure that staff have a solid understanding of the fundamentals of financial control. Using such an approach, the Department should ensure that all overpayments from problem files and high-risk dormant files are properly identified and recovered.

Department's response: *HRDC agrees with this recommendation and has taken action.*

The Department had acknowledged the need for ongoing monitoring to ensure that staff have a solid understanding of the fundamentals of financial control.

This is being addressed through two measures: a new quality assurance process and the Performance Tracking Directorate. These are permanent processes and structures to detect and correct problem files, and to identify and correct deficiencies in operational policy, procedures, and employee knowledge and skills.

The new quality assurance initiative was undertaken in June 2000 to increase program expertise at the local office level. New senior operations consultants will now conduct a quality review of selected files to identify problems at the earliest possible time. In addition, financial administrators and program delivery staff have re-established a financial post-audit program at the national and regional office levels. This financial post-audit program includes the validation of expenditures in order to allow financial officers assurance that payments are in support of services provided or goods received in accordance with the prescribed policies and procedures. When either of these processes detects a problem file, it will be corrected and an adjustment or overpayment established if required.

HRDC also established a Performance Tracking Directorate, which is sampling a statistically valid selection of project files from across the country. Errors, when detected, are returned to the appropriate office for correction and establishment of an overpayment if necessary. In addition, patterns and trends are communicated to all offices delivering grant and contribution programs, with appropriate guidance and direction to reduce or eliminate such errors in the future.

The Department recognizes the importance of identifying potential overpayments and subjecting such problem cases to careful and consistent *review. As part of the Six-Point Action Plan, HRDC has identified and reviewed a sample of dormant files from 1998-99 and 1999-2000. As recommended by the Auditor General, the Department has since added a quality control step to this process. Following the review by program delivery staff, Internal Audit Bureau staff have been scrutinizing the work and conducting selected on-site reviews of higher-risk projects to ensure that all potential overpayments are identified and established.*

The results of the dormant file review will be published in fall 2000. In addition, HRDC will engage a private sector consulting firm to examine the Department's work and advise whether in accordance with the principle of due diligence it is cost-effective to review additional files.

11.150 The Department should ensure that key controls are strengthened as it committed to do in the Six-Point Action Plan and that they are supported by a strong internal audit function that meets the highest professional standards. The Department should also ensure that it has a well-established system for implementing and following up on corrective action resulting from internal audits.

Department's response: *HRDC agrees with this recommendation and has taken action.*

The Department continues to be committed to implementing the Six-Point Action Plan, including key control processes and mechanisms. As demonstrated in the progress reports issued in May and September, HRDC is reporting publicly on its achievement of the Action Plan and will continue to do so until the Plan is implemented in its entirety. In addition, as indicated in the government's response to the Third Report of the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, HRDC is committed to reporting on the impact of its corrective measures in future departmental performance reports. HRDC has already contracted PricewaterhouseCoopers to conduct a second independent assessment of the implementation of the Action Plan in January 2001.

The Department has a professional Internal Audit Bureau in place and has recently acted to strengthen the role and profile of internal audit through a renewed Departmental Audit and Evaluation committee. This committee, which is one of five main executive committees, is responsible for ensuring that the Department takes corrective action on all internal audit recommendations. This action will also promote a culture of continuous learning from audits and evaluations.

Although not a part of the Department's Internal Audit Bureau, HRDC has budgeted $2.7 million annually for the national Grant and Contribution Performance Tracking Directorate. This directorate provides a consistent and continuous measurement of HRDC's compliance with file documentation requirements and fundamental financial controls. In its first report in August 2000, the Directorate confirmed that "there has been a significant, measurable improvement in overall program management and administration of grants and contributions since the 1999 internal audit." The Department has committed to publishing performance tracking results quarterly.

11.151 The Department should complete its study of program management, which is designed to ensure that desired results of grant and contribution programs are clearly defined and that results are appropriately measured and used to identify any necessary changes. In consultation with the Treasury Board Secretariat, the Department should ensure that it meets its proposed time frame for analyzing the objectives of all

its grant and contribution programs and implementing appropriate changes, including measurement of results.

Department's response: *The Department agrees with this recommendation and has taken action.*

In May 2000, HRDC embarked on an extensive program management study that is designed to review the management and results focus of all grant and contribution programs within the Department. This study is intended to strengthen program management and performance by:

- *developing results-based management and accountability frameworks for all programs;*
- *improving communication on lessons learned across programs; and*
- *ensuring all program authorities comply with the reporting requirements set out in the Social Union Framework Agreement.*

Above all, the program management study will ensure that all programs have clear objectives that shape the design and direction of the program and that they have an integrated audit and evaluation cycle. In addition, HRDC is expanding the study to incorporate a more thorough review of how program design and program information can support equality of access to programs.

This work will result in an enhanced departmental capacity to improve HRDC's grant and contribution programs. It will establish a cycle of continuous improvement in policy and program design as well as program management and administration.

This work is being carried out in co-operation with the Treasury Board Secretariat. In June 2000, the Treasury Board introduced a revised Policy on Transfer Payments to promote long-term, government-wide improvements to grant and contribution program administration. The new policy requires departments to review and resubmit their program authorities by 31 March 2005.

HRDC is fast tracking this work. As part of the program management study, all HRDC programs will have reassessed and strengthened their design, management, and accountability frameworks by 31 March 2001. The Department will then resubmit all grant and contribution program authorities to the Treasury Board by the end of 2002.

11.152 The Department should assess whether the information it provides to Canadians on grant and contribution programs adequately promotes equality of access, and it should take corrective action as required.

Department's response: *The Department agrees with this recommendation and has taken action.*

The Department is presently using a range of methods and techniques to provide information in a manner that promotes equality of access. In addition, HRDC is taking steps to increase the information available to Canadians on its grant and contribution programs and to make this information more accessible.

Specifically, HRDC will ensure that by December 2000, descriptions of all programs, including terms and conditions, eligibility requirements, and information on how to apply, is available on its public Web site, in every HRDC office, and to every member of Parliament.

HRDC will examine this issue further as part of the program management study referred to in the response following paragraph 11.151 and will specifically document in the program design process the accessibility and equality of access requirements. For many of these programs, HRDC believes that it will be important to consider the role of a consultative process in the community that reaches all prospective sponsors and that *complements the information provided to all Canadians on its programs.*

11.153 The Department should ensure that management sustains its current strong support for change to ensure that actions to equip and support staff are fully implemented and the required tools and systems provided. It should conduct ongoing monitoring of the impacts of the new tools and training and the concepts and approaches being implemented. It should also ensure that the new information system for grants and contributions is fully integrated with the Department's financial system.

Department's response: *HRDC agrees with this recommendation and has taken action.*

As recognized by the Pricewaterhouse-Coopers independent assessment of the Department's implementation of the Action Plan, "substantial senior level management involvement has been devoted to ensure progress in achieving the various activities that support the commitments under each of the six points of the Plan." Continuing management support is assured through measures taken in April establishing explicit accountability in implementing the Six-Point Action Plan for every executive with responsibility for a grant and contribution program.

In addition, HRDC has committed to reporting publicly on a quarterly basis until the Plan is implemented, and to reporting annually on the impact of its corrective measures in the departmental performance report to Parliament.

The Department recognizes the importance of well-trained and well-equipped staff in delivering grant and contribution programs. As indicated in the Department's progress reports and in the government's response to the Standing Committee, HRDC has fulfilled Action Plan commitments and taken additional initiatives to provide staff with appropriate operational policy guidance, standardized training, and improved information management systems. The Department specifically commits to monitoring and assessing the impact of operational policies and training, and to ensuring that the new information systems for grant and contribution programs are fully integrated with the departmental financial system.

11.154 In collaboration with the Treasury Board Secretariat, the Department should complete a workload analysis of the resources required to deliver different types of grant and contribution programs.

Department's response: *HRDC agrees with this recommendation and has taken action.*

As indicated in the response to the Standing Committee, HRDC reallocated resources in July from within its existing budget to increase the number of staff with specific responsibility for the administration of grant and contribution programs. This reallocation was based on a preliminary analysis of staffing, training and systems requirements. HRDC has since undertaken a comprehensive analysis of workload, which will be completed by December 2000.

In fall 2000, the Department is also initiating a third-party review of delivery models for grant and contribution programs. This review will assess HRDC's delivery structure in relation to those of other federal departments and will assess the appropriate balance between local, regional, and national delivery of grant and contribution programs. This review will take into account the variety of HRDC programs, the nature of partnership agreements resulting from the Employment Insurance Act *and the Social Union Framework Agreement, and the existing capacity within the Department.*

These reviews will be the basis for further discussions with the Treasury Board Secretariat concerning the Department's resource requirements in delivering grant and contribution programs.

Department's overall comment: *The Department takes seriously all the issues raised in the chapter and in the 1999 internal audit of grant and contribution programs.*

The Department is determined to build on the improvements it has already made to its administration of grant and contribution programs. HRDC will fulfil its Action Plan. It will complete the other supporting initiatives undertaken following the launch of the Plan. Furthermore, HRDC is undertaking additional steps to strengthen these actions in response to this chapter.

The challenge, as confirmed by the Auditor General, is to achieve the right balance between efficient and flexible program delivery and sound financial management. The Auditor General's report will help the Department consistently achieve program delivery that meets the needs of the Canadians it serves as well as the sound financial management that Canadians expect.

This chapter recognizes that the Department has made good progress with respect to the Six-Point Action Plan and related initiatives. It also emphasizes the need for HRDC to sustain the changes that are under way. HRDC acknowledges the need to undertake continuous work in this respect. As a result, HRDC will more explicitly incorporate the principles of modern comptrollership, or managing for excellence, as an ongoing foundation for the fundamental changes being made to its administration of grant and contribution programs.

By strengthening and integrating its work on modern comptrollership, the Department will be well positioned to fully respond to the Auditor General's statement that HRDC "needs to make today's extraordinary effort tomorrow's routine." This work will also help promote a culture of continuous learning and improvement.

In response to this chapter, HRDC will take a number of further steps. Specifically:

- *HRDC commits to working closely with all stakeholders, including the Treasury Board Secretariat, in the preparation of a report on the balance between effective program delivery and sound financial controls. HRDC will report by June 2001 to the Standing Committee on Human Resources Development and the Status of Persons with Disabilities on the Department's comprehensive efforts in achieving the right balance.*

- *HRDC confirms that it will publish the results of the review of a sample of dormant files this fall. The Department will also engage an independent expert to examine its review and advise whether, in accordance with the principle of due diligence, it is cost-effective to assess additional files. This is consistent with HRDC's commitment to being open and transparent in the implementation of the Action Plan and the administration of grant and contribution programs.*

- *HRDC will ensure that by December 2000, descriptions of all programs, including terms and conditions, eligibility requirements, and information on how to apply, are available on its public Web site, in every HRDC office, and to every member of Parliament. This action responds to the Auditor General's observations about the need to ensure that information about programs is widely available and accessible.*

- *HRDC is expanding the program management study to incorporate a more thorough review of how program design and program information can support equality of access to programs.*

In reviewing the chapter, HRDC is pleased that the Auditor General recognizes the following:

- *that the Department's "actions and plans also address the deficiencies we found in our audit";*
- *that the Department "has made good progress toward meeting the commitments in its Six-Point Action Plan" and that "work is also proceeding on additional initiatives that expand or complement the original Action Plan"; and*
- *that HRDC's "Performance Tracking Directorate represents good progress. If properly implemented, it should give management an ongoing measure of performance in the management and control of grants and contributions."*

HRDC also notes that:

- *the Auditor General's audit was based on files that were closed before January 2000. Therefore, with the exception of a few projects that had been extended, the period covered by the Auditor General's audit precedes the corrective action by the Department;*
- *the Department has asked for the advice of the Standing Committee on any changes that might strengthen the project selection process in relation to grant and contribution programs. This will include the role of members of Parliament, who are well placed to advise on the various interests of the communities they represent; and*
- *with respect to efficiency, flexibility and control, the Auditor General recognized that "there is no simple answer to what the balance should be."*

The Report acknowledges the broad range of initiatives HRDC has taken since the internal audit was conducted in 1999. In this respect, the Department has:

- *launched a Six-Point Action Plan to strengthen administration of grant and contribution programs, including the establishment of the Performance Tracking Directorate to assess adherence to policies, and the provision of extensive training and better tools to staff;*
- *complied with the new Treasury Board Policy on Transfer Payments to further strengthen the administration of grant and contribution programs;*
- *introduced a new quality assurance process to detect and correct errors at the earliest possible time;*
- *initiated actions to improve accountability structures and management processes within the Department;*
- *released two progress reports and the response to the Standing Committee report of June 2000; and*
- *initiated a comprehensive program management study to ensure that the objectives of all grant and contribution programs are clearly defined and that performance measures are in place to demonstrate that these objectives are met.*

In summary HRDC confirms its commitment to making fundamental and permanent improvements to the management and administration of its grant and contribution programs. HRDC will continue to work with all interested parties to ensure that it achieves the right balance between responsive client service and prudent management of taxpayers' money.

Part II — Four Programs Audited

Introduction

11.155 We audited four grant and contribution programs, with particular emphasis on key aspects of project management, program design and the measurement of results. Here, in Part II of the chapter, we present our audit findings and conclusions on each of the following programs:

- Transitional Jobs Fund/Canada Jobs Fund (TJF/CJF)
- Youth Internship Canada (YIC)
- Social Development Partnerships Program (SDPP)
- Sectoral Partnerships Initiative (SPI)

The period covered by our audit preceded corrective action by the Department

11.156 In order to audit the full life cycle of projects, we drew our sample from projects that had closed by January 2000. Therefore, with the exception of a few projects that had been extended by amending the contribution agreements, our audit preceded the corrective action the Department took following its 1999 internal audit.

Sampling allowed valid conclusions on each program audited

11.157 To be able to draw valid conclusions on each program as a whole, we selected all high-value projects from the populations of files we audited and stratified random samples from the remaining projects.

11.158 Transitional Jobs Fund/Canada Jobs Fund. The TJF program terminated on 31 March 1999. We included in our sample all 10 of the high-value projects that received more than $2 million each in HRDC contributions. We took a stratified random sample of 64 files from all other completed projects (1,080) over the life of the program. In CJF, we sampled 32 of 62 projects with planned end dates up to 31 December 1999 and selected all four of the projects with a high value (over $503,560). The total value of the projects selected in both programs was approximately $70 million.

11.159 Youth Internship Canada. We drew our audit sample from 8,084 projects across Canada with a total value of $185 million that were active between 1 April 1998 and 31 December 1999. We selected a stratified random sample of 77 projects — 57 with a value of up to $10,100 and 20 with a value over $10,100. Among the larger projects, we included all seven that received a contribution of over $606,000. The total value of the projects we selected was over $18.5 million.

11.160 Social Development Partnerships. This program uses grants as well as contributions. We drew our audit sample of contributions from 114 projects that were active between April 1998 and December 1999. We selected a stratified sample of projects, and included all the high-value projects (over $495,000). Our sample consisted of 47 contribution projects totalling $11.2 million. Five of these were high-value projects. We reviewed the full population of 26 grants; they ranged from about $120,000 to $3 million; two were in the range of $2 million to $3 million.

11.161 Sectoral Partnerships Initiative. From the 119 SPI projects that closed before January 2000, we drew the five highest-value projects, worth a total of $18.9 million. We also drew a stratified random sample of 44 projects worth a total of $10.8 million. Many of these projects had received funding over several years. In all, HRDC had contributed $47.1 million for the 119 closed projects. The two smallest projects we audited had each received $10,000 and the largest, $6.5 million.

Transitional Jobs Fund/Canada Jobs Fund

Program Description

11.162 The Transitional Jobs Fund (TJF) was a three-year initiative launched in July 1996. This program was implemented at the same time as the Employment Insurance (EI) reform and was designed to assist geographical areas that have historically relied more heavily on Employment Insurance and therefore would be more severely affected by changes to that program.

11.163 The objective of TJF was to create long-term, sustainable jobs for individuals. HRDC was to achieve this objective by working with the private sector, provincial and municipal governments, other federal government departments, community partners, and other organizations to generate new, permanent jobs in affected communities.

11.164 TJF received a total of $300 million in funding. It ended on 31 March 1999 and was replaced by the Canada Jobs Fund (CJF), with annual funding of $110 million. Unlike TJF, which had not been allocated an operating budget, the annual funding for CJF included almost $20 million to deliver the program. CJF was similar to TJF but had an additional objective, to strengthen communities' capacity to become self-reliant. In June 2000 the government announced that CJF would be discontinued and the associated funding redirected to federal regional economic development agencies. However, HRDC was to process any applications it had received and would manage ongoing CJF projects to their completion.

11.165 During the three years of TJF, over 1,000 projects were funded through contributions. Under CJF, 430 projects were approved in 1999-2000. The government has indicated that these programs created new jobs and leveraged millions of dollars in funding by partners. Exhibit 11.4 presents a breakdown by region of the budgets and expenditures for these programs over the last four years. Exhibit 11.5 provides examples of typical projects.

Program Design

11.166 On 26 February 1996, Cabinet agreed that a $300 million transition fund would be established for a specified period to support job creation in areas of high unemployment affected by Employment Insurance reform. In June 1996, the Treasury Board approved the terms and conditions and the funding for the TJF. The terms and conditions stipulated, among other things, eligible activities, guidelines, content of proposals, eligible categories of expenditure, authority to approve proposals and payments, and evaluation criteria. In July 1996, HRDC developed brief operational guidelines for the program.

11.167 In December 1998, Cabinet agreed that the TJF should be continued at $110 million per year and renamed the Canada Jobs Fund. The CJF was to facilitate human and social development by working with partners, particularly in the private sector, to generate the sustainable economic activity needed to create jobs in regions and communities of high unemployment (10 percent or more).

11.168 The Treasury Board approved the terms and conditions of the CJF in March 1999. They were similar to those of the TJF but in some aspects were more specific, building on the experience and knowledge acquired through the TJF. For example, the results of a 1998 TJF program evaluation led to some changes, such as better co-ordination with regional economic development agencies. Also, the Department's operational guidelines for CJF were more comprehensive and included criteria such as targeting small and medium-sized businesses and ensuring that the program was used as

The objective of the Transitional Jobs Fund (TJF) was to create long-term, sustainable jobs in areas of high unemployment affected by Employment Insurance reform.

The Canada Jobs Fund (CJF) was similar to the Transitional Jobs Fund.

"last resort" funding. Exhibit 11.6 presents the key elements of TJF and CJF as set out in their terms and conditions and the guidelines.

Difficulties in targeting TJF

A wide range of approaches was used to establish areas of eligibility for TJF.

11.169 As a general rule, the Department decided that the program should be targeted to areas of the country and to areas within communities where unemployment rates were 12 percent or higher. The overall budget for TJF was allocated among HRDC regions (generally provinces — see Exhibit 11.4) on the basis of two criteria: the number of Employment Insurance claimants in EI regions where the unemployment rate had exceeded 12 percent in 1995 (75 percent of the budget); and the anticipated decline in Employment Insurance benefits to provinces and territories as a result of EI reform (25 percent of the budget).

11.170 The responsibility to define specific areas of eligibility within HRDC regions was left to regional and local HRDC officials so that regional and local needs could be taken into account.

11.171 We noted a wide range of approaches used by regional offices to establish areas of eligibility for TJF and to determine whether geographical areas within communities were eligible or not. Data were obtained from various sources, including Statistics Canada's Census and Labour Force Survey. As well, labour market information developed at the local level by HRDC officials was used. In addition, regional and local officials identified projects that met specific community concerns, or projects that

Exhibit 11.4

Budgets and Expenditures of Transitional Jobs Fund and Canada Jobs Fund

($ thousands)

	TJF						**CJF**	
HRDC Regions	**1996-97**		**1997-98**		**1998-99**		**1999-2000**	
	Budget	**Actual**	**Budget**	**Actual**	**Budget**	**Actual**	**Budget**	**Actual**
Newfoundland	9,198	4,001	22,560	20,920	15,966	20,011	12,022	7,242
P.E.I.	1,848	633	4,532	4,924	3,208	3,549	2,498	3,293
Nova Scotia	5,520	258	13,539	9,883	9,581	19,954	8,058	1,857
New Brunswick	4,928	2,709	12,088	8,874	8,555	15,660	9,037	3,707
Quebec	18,256	8,135	44,783	45,155	31,692	32,642	33,630	14,042
Ontario	5,408	3,119	13,264	9,389	9,387	17,715	9,227	4,400
Manitoba	1,328	308	3,256	3,286	2,304	1,317	1,679	64
Saskatchewan	1,257	294	3,084	1,869	2,182	2,753	1,718	67
B.C./Yukon	4,015	465	9,848	9,365	6,969	9,143	5,623	2,232
Alberta/Nunavut/N.W.T	1,242	346	3,046	1,778	2,156	3,223	1,517	0
Unallocated	7,000		10,000		8,000		5,020	
Total	**60,000**	**20,268**	**140,000**	**115,443**	**100,000**	**125,967**	**90,029**	**36,904**
Operating							**19,971**	**not available**

Source: Departmental records

would have positive impacts on high unemployment rates in surrounding areas.

11.172 Employment Insurance economic regions are currently the smallest geographical areas for which Labour Force Survey estimates of unemployment are available. Statistics Canada also publishes some relevant information on a limited number of cities. The information sources used by regional offices to target the program to local areas outside the EI regions that qualified (those with unemployment rates of 12 percent or higher) were not as reliable as the official measures of unemployment.

11.173 Funding projects in local areas that were outside qualifying EI regions was an important part of the program's overall design. According to the Department, allocations to these areas accounted for almost 40 percent of approved TJF projects. In our opinion, the ability to target the program equitably was compromised by the difficulty of estimating with reasonable accuracy the unemployment rates in such areas.

Targeting of CJF was more systematic

11.174 To allocate the CJF budget among its regions, the Department used an approach similar to that used for TJF. Two thirds of the funds were allocated among EI regions with unemployment rates of 10 percent or higher. An additional 8 percent was allocated among regions with unemployment rates of 15 percent or higher. The remaining 25 percent of the total budget was allocated by province and territory according to the reduction in EI benefits imposed by EI reform.

11.175 CJF terms and conditions were more precise in defining high unemployment regions and subregions. In July 1999, HRDC's Chief Actuary was asked to recommend an acceptable methodology for determining the eligibility of subregions. He recommended using Statistics Canada's Labour Force Survey, the source of data whose use for targeting government programs on the basis of unemployment rates could be fully defended. We concur with this recommendation.

Exhibit 11.5

Typical Projects Funded by the Transitional Jobs Fund and the Canada Jobs Fund

1. An existing company wants to expand its market share by implementing new activities. This company establishes the new activities in an area of high unemployment. Funds are needed to build a new plant, to install equipment and to train employees. The plant will create seasonal and full-time jobs in the area. Partners sharing the cost of the project are a commercial bank (20 percent), the provincial government (30 percent) and the sponsor (10 percent). HRDC's contribution (40 percent) is for capital costs. The jobs will be created once the plant is built and the equipment installed.
2. An existing sawmill operating only during the warm season wants to rejuvenate its facilities to be able to work year-round. The project consists of strengthening the existing structure and acquiring more equipment. This should result in increased production and the creation of new sustainable jobs. HRDC is financing capital costs, while a commercial bank and the project sponsor are partnering for salary costs. HRDC's contribution amounts to 50 percent of the project's total cost.
3. An existing manufacturing company is awarded a major contract for five years, with a possibility of renewal. This will require the company to increase production, and it needs to acquire additional equipment and add an additional shift to increase capacity. The project will create several full-time jobs once the equipment is installed. Partners in the project include a federal economic development agency (10 percent), the provincial government (50 percent), the local development agency (10 percent) and the sponsor (20 percent). HRDC's contribution (10 percent) will finance the salaries of the new employees — up to $10,000 for each job created.

Source: Departmental records

"last resort" funding. Exhibit 11.6 presents the key elements of TJF and CJF as set out in their terms and conditions and the guidelines.

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11.170 The responsibility to define specific areas of eligibility within HRDC regions was left to regional and local HRDC officials so that regional and local needs could be taken into account.

11.171 We noted a wide range of approaches used by regional offices to establish areas of eligibility for TJF and to determine whether geographical areas within communities were eligible or not. Data were obtained from various sources, including Statistics Canada's Census and Labour Force Survey. As well, labour market information developed at the local level by HRDC officials was used. In addition, regional and local officials identified projects that met specific community concerns, or projects that

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2. **An existing sawmill operating only during the warm season wants to rejuvenate its facilities to be able to work year-round. The project consists of strengthening the existing structure and acquiring more equipment. This should result in increased production and the creation of new sustainable jobs. HRDC is financing capital costs, while a commercial bank and the project sponsor are partnering for salary costs. HRDC's contribution amounts to 50 percent of the project's total cost.**
3. **An existing manufacturing company is awarded a major contract for five years, with a possibility of renewal. This will require the company to increase production, and it needs to acquire additional equipment and add an additional shift to increase capacity. The project will create several full-time jobs once the equipment is installed. Partners in the project include a federal economic development agency (10 percent), the provincial government (50 percent), the local development agency (10 percent) and the sponsor (20 percent). HRDC's contribution (10 percent) will finance the salaries of the new employees — up to $10,000 for each job created.**

Source: Departmental records

Some aspects of the programs were difficult to implement

11.176 The design of TJF and CJF emphasized a partnership approach and the leveraging of funds from other sources. This emphasis required HRDC's local offices to develop and maintain collaborative partnerships with local private sector organizations, regional economic development agencies and provincial and municipal governments. Many project officers told us that this and other design elements meant that they needed new skills to deliver these programs. For example, many project officers told us that they did not have the business expertise required to assess business plans — a key part of project assessment — and did not receive sufficient training and support.

11.177 We found that the programs' terms and conditions and the operational

Exhibit 11.6

Key Elements of the Transitional Jobs Fund/Canada Jobs Fund Programs

	TJF		CJF	
Key Elements	**Terms and conditions**	**Operational Guidelines**	**Terms and conditions**	**Operational Guidelines**
Objectives				
Creation of long-term sustainable jobs.	✓	✓	✓	✓
Working in collaboration with partners.	✓	✓	✓	✓
Strengthening the capacity of communities to become self-reliant.			✓	✓
Areas of eligibility.				
Areas of high unemployment affected by Employment Insurance reform.	✓	✓	✓	✓
Areas of the country and geographical areas within communities that have an unemployment rate of 12% or higher.		✓		
EI regions with an unemployment rate of 10% or higher.			✓	✓
Subregional areas of high, systemic, significant and prolonged unemployment.		✓	✓	✓
Guidelines				
HRDC's maximum financial contribution to any project is 50% of project costs.		✓	✓	✓
Funding of last resort.				✓
Focus on small and medium-size businesses.				✓
The province/territory must agree that the project be funded.	✓	✓	✓	✓
Written recommendation for all projects from the area's Member of Parliament.		✓		✓
Maximum duration of agreements will not normally exceed one year.	✓	✓	✓	✓

Source: Programs' Terms and Conditions, and HRDC's Operational Guidelines

guidelines were not sufficiently spelled out to help project officers decide who and what were eligible for funding, under what conditions, for what purposes, and in what amounts. We recognize that some local flexibility was desirable to allow the programs to be tailored to local circumstances. However, we noted inconsistencies among local offices in the interpretation of such fundamental matters as the programs' objectives and in the application of eligibility criteria, especially in the case of TJF.

11.178 For example, one local office would see the program's objective as direct job creation and would fund only projects that would create jobs directly and immediately, or in the very short term. Another office would focus more on general economic development and would fund projects that might stimulate economic activity and create jobs only indirectly and in the future. In terms of project duration, one office would recommend approval of only those projects that would last less than a year. Another would recommend approval of projects that were to last up to three years, but would arrange for three consecutive agreements of less than a year each.

11.179 Key elements of the programs were not always defined clearly, and in some cases they potentially conflicted with other aspects. For example, operational guidelines for CJF required that HRDC funding be used only as a last resort. This criterion could lead to the funding of higher-risk projects, which could conflict with the program's objective of creating sustainable jobs. Project officers told us that they found this criterion particularly difficult to apply. The Department developed guidance in April 2000, and was implementing it as we carried out our audit.

11.180 All projects had to be approved by the Minister of Human Resources Development, even though the terms and conditions of both programs provided for delegation of that authority. (One exception to this practice was the current Minister's delegation to the Deputy Minister of authority for approval of projects located in the Minister's riding.) Although the need for the Minister to approve all projects was only one contributing factor, we noted that frequently it took a long time — in some cases, months — to get projects approved. This was a source of frustration to HRDC officials as well as project sponsors.

11.181 Operational guidelines for TJF and CJF required a written recommendation for a project from the local member of Parliament. We recognize that this practice can add important input to the assessment of proposals. However, accountability is unclear when, on the one hand, Parliament approves funding and scrutinizes the government's performance in delivering programs, and on the other hand, parliamentarians have a role in the programs' decision-making processes.

We noted inconsistencies among local offices in the interpretation of such fundamental matters as the programs' objectives and in the application of eligibility criteria.

Equal access to these programs was not ensured

11.182 The Minister of HRD issued a news release at the introduction of both TJF and CJF. HRDC headquarters and regional offices played only a limited role in promoting these programs.

11.183 Local offices were responsible for informing potential proponents about the programs. Some offices relied heavily for this on their partners, including economic development agencies or provincial government departments. Others developed information kits and promoted the programs through their involvement in the community. We saw evidence that members of Parliament had received information on the programs, and we were told that some had been instrumental in marketing them. Public announcements of approved projects also helped to raise awareness among potential proponents of projects. Some offices told us that they did not want to promote the programs heavily because the program budgets were limited.

In our view, the variation in the methods used to promote the programs did not ensure equal access by potential applicants.

11.184 In our view, the variation in the methods used to promote the programs across and within HRDC regions, including in local areas that were outside qualifying EI regions but may nevertheless have qualified by virtue of "pockets" of high unemployment, did not ensure equal access by potential applicants.

Project Selection and Approval

Key information was missing from many proposals

We concluded that fewer than five percent of TJF and CJF projects were adequately assessed.

11.185 We found that project officers did not always have the information they needed to assess a project properly. Although proposals or business plans were submitted to HRDC for almost all projects, most of them lacked key information (74 percent in TJF and 57 percent in CJF). Information that was missing included the characteristics of jobs to be created, projected cash flows and budgets, and a clear time frame for projects. We noted also that proposals did not always provide, nor did HRDC always request, information on the nature and purpose of funding provided by other partners in a project. This prevented HRDC from determining the risk of double funding and, in CJF, determining whether HRDC funding was truly a last resort.

We found several deficiencies in project assessments

11.186 We concluded that fewer than five percent of projects were adequately assessed. In 30 percent of TJF projects and 29 percent of CJF projects, we could not find evidence that proposed activities had been analyzed to evaluate the likelihood that they would create sustainable jobs. We saw projects approved, for example, that would create only short-term jobs or that might create sustainable jobs only in the future (see Exhibit 11.7).

11.187 Many project officers told us that they did not question the incremental impact of the HRDC contribution — that is, whether the project would have gone ahead without funding by HRDC. Indeed, evidence on file indicated that almost 63 percent of TJF projects and 75 percent of CJF projects would probably have gone ahead without HRDC funding, although its contribution might have advanced the timetable or helped increase the scale of some projects. Some projects had already been completed by the time the contribution agreement was signed (see Exhibit 11.8).

11.188 In 74 percent of TJF projects it was not evident that the potential need for environmental assessments had been considered. Project officers told us, however, that HRDC often relied on its partners to ensure that where environmental assessments were needed they were done. The situation improved under CJF: environmental screening was performed in 36 percent of all projects.

Exhibit 11.7

No Creation of Direct Sustainable Jobs – St. Martins Beautification Society Inc., New Brunswick

The objective of the project was to assist in the construction of tourism facilities in St. Martins, New Brunswick with a view to connecting communities to the Fundy Parkway and thereby helping to develop the Fundy National Park. This project was part of an overall development project headed by the province of New Brunswick through the Fundy Trail Development Authority.

The project received over $80,000 in TJF contributions in 1998–99, although no direct sustainable jobs were to be created by the project itself. However, HRDC estimated that indirect permanent seasonal work would be created for 26 to 60 persons.

HRDC claimed that the project created 34 jobs. However, these 34 jobs correspond to the number of employees who worked on the overall Fundy National Park project and not directly on the St. Martins Beautification Society Inc. project.

Source: Departmental records

11.189 Other aspects that project officers seldom considered included the possibility that other HRDC programs were funding the same project, or that a project sponsor still owed HRDC repayment of funds under previous agreements. Finally, we saw little or no evidence that when a subsequent phase of a project was assessed for funding, results of the previous phase were considered.

Approvals were not always supported by relevant information

11.190 The terms and conditions of both programs clearly stated that no financial assistance could be provided without the agreement of the appropriate provincial or territorial government. With one exception, we found evidence of this agreement in all cases. A recommendation from the local member of Parliament was on file in most cases.

11.191 We found that in some cases the Minister had not received all relevant information before approving a project. For example, we found cases where the Minister was not informed that the province, the local member of Parliament or a key partner had raised concerns about it.

11.192 Finally, we found cases where project approvals were not based on established procedures (see Exhibit 11.9). In our opinion, some of these projects did not meet the eligibility criteria.

Financial Management and Control

Many contribution agreements lacked key information

11.193 Signed agreements and schedules were on file for 95 percent of TJF projects and 92 percent of CJF projects. For the most part, the agreements or schedules reflected the Minister's approval. However, in 74 percent of TJF projects and 63 percent of CJF projects, key information was missing, or was unclear. In some cases, eligible costs were not described; in others, the activities to be completed were not indicated. We saw agreements that did not specify a funding period, or that simply stated the number of jobs to be created without indicating any characteristics of the jobs or describing how the project would ensure that the jobs were created.

The agreement of the appropriate provincial or territorial government and a recommendation from the local member of Parliament were on file in most cases.

11.194 We also found contradictory information in some contracts and their related schedules. For example, one section of the schedule would indicate that payments would be made on the basis of jobs created and salaries, while another section of the same agreement would indicate that the funding would be for capital purchases. These inconsistencies in agreements make it more difficult to carry out the activity and financial monitoring required to ensure that the project meets its objectives and uses the funds for agreed purposes.

11.195 About 30 percent of the agreements were formally amended in

Exhibit 11.8

Project Completed Before Contribution Agreement Signed – Jerseyman's Island Cod Farm, Newfoundland

The Minister approved the project on 28 October 1999 and the agreement was signed on 8 November 1999 – after the project had been completed. The funding period was from 8 November 1999 to 11 December 1999 and HRDC paid the full amount of the contribution ($15,000) on 30 November 1999.

The Department's view is that the project expenditures were incurred after the Minister's approval and before the release of funds by HRDC on 30 November 1999.

Supporting documentation provided to us was for expenditures incurred before the funding period. This project had been funded earlier under TJF.

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The Department's view is that the project expenditures were incurred after the Minister's approval and before the release of funds by HRDC on 30 November 1999.

Supporting documentation provided to us was for expenditures incurred before the funding period. This project had been funded earlier under TJF.

Source: Departmental records

Exhibit 11.9

Project Approvals Not Based on Established Procedures

New Brunswick Department of Natural Resources and Energy – $6,000,000 to supplement provincial funding of silviculture activities by private woodlot owners

The Minister made a commitment to the Government of New Brunswick to fund the project before HRDC officials had received and reviewed the proposal to ensure that it met the eligibility criteria.

New Brunswick's Minister of Natural Resources and Energy submitted a request for funding to the Minister of Human Resources Development in May 1996, after TJF was announced but before it was implemented on 1 July 1996. In a 17 July 1996 letter to New Brunswick's Minister of Natural Resources and Energy, the Minister indicated he was prepared to provide TJF funding of $2 million per year for 1996, 1997 and 1998.

The regional office was informed that the Minister had made a commitment to New Brunswick for $6 million over three years. The regional office worked with provincial officials to develop the details of the proposal and then prepared a recommendation for approval. The Minister approved the project on 15 August 1996.

In our view, the project did not meet TJF criteria, as no new sustainable jobs were being created. We note that similar projects were subsequently approved in Newfoundland ($11.5 million) and Quebec ($5.7 million).

Auberge des Gouverneurs (9047-4412 Québec Inc.) – $600,000 for construction of a hotel complex

The Minister announced that the federal government would contribute $600,000 to this project, which was to create 60 jobs. After assessing the project, Human Resource Centre of Canada (HRCC) officials decided to fund it under TJF to create 40 jobs. However, the funding remained unchanged, resulting in a higher cost per job. The project was announced before it was approved.

On 10 February 1997, the local HRCC received a fax from the Prime Minister's constituency office concerning the project, suggesting that the HRCC contact an official in the office of the Minister of Human Resources Development for more details.

On 13 March 1997, the Minister issued a press release to announce funding of up to $600,000 and the creation of 60 jobs under the Targeted Wage Subsidies program.

Discussions between the local HRCC and the sponsor identified TJF as a more appropriate program to fund this project. After receiving a proposal and business plan on 4 April 1997, the local office confirmed that the project met TJF criteria. The HRDC regional office agreed with the assessment but established that only 40 of the 60 jobs were eligible for funding under TJF. However, the recommended amount of funding was not reduced accordingly, even though the cost per job exceeded regional guidelines ($10,000 per job).

On 4 July 1997, the Minister's office announced a contribution of $600,000 for the creation of 40 jobs under TJF. The project was formally approved on 9 July 1997.

In the Department's view, there was no requirement in the program to maintain a $10,000 ceiling per job.

In our view, the project met the TJF criteria.

Chelson's Distribution Ltd. – New Brunswick – $84,000 for construction and furnishing of cottages

The amount of the contribution recommended by HRDC officials was increased at the approval stage without explanation.

The proponent applied in October 1998 for a TJF contribution. During a site visit in November 1998, the project officer indicated to the proponent that funding up to $82,000 could be possible. In December 1998, the project officer informed the proponent that the project would be recommended but for $50,000, a lesser amount than the proponent had expected. The proponent called the project officer and expressed frustration.

In June 1999, the project officer recommended a CJF contribution of $60,000. The HRDC regional office reviewed the assessment of the project officer and concurred with it.

This CJF project was approved by the Minister with funding of $84,000 – $24,000 more than officials had recommended.

In our view, this project did not meet CJF criteria as there was no evidence of funding of last resort. In addition, the project activities had been largely completed before ministerial approval was obtained.

Exhibit 11.9 (continued)

Cochran Entertainment Inc – Nova Scotia – $2,500,000 for production of a television series

Before HRDC officials had completed their assessment of the project and recommended its approval, the Minister informed the proponent that HRDC would participate in funding the project.

As early as February 1998, HRDC officials were in contact with the sponsor and other partners concerning a proposal for the project. A 25 March 1998 e-mail from the Minister's office to the HRDC regional office asked if HRDC could help in financing and noted that a decision was required before 7 April 1998.

On 3 April regional officers advised the Minister's office that they had met with the proponent and that there were still information gaps and questions about the sustainability of jobs.

A 9 April 1998 letter to the proponent from the Minister confirmed funding not exceeding $2.5 million under TJF, subject to the execution of a contribution agreement. An e-mail dated 14 April 1998 from the regional office to a project officer in the local office indicated that there were difficulties with the proposal, as it included short-term jobs.

On 21 April 1998, the regional office recommended approval, and the Minister approved the project on 30 April 1998.

In the view of the Department, there is evidence on file that supports that established procedures for the assessment and recommendation of TJF projects were followed, and that the project would have created 100 sustainable jobs had CBC cutbacks and cancellation of the series not occurred.

In our view, this project did not meet TJF criteria, as it created short-term rather than sustainable jobs.

Source: Analysis based on departmental records

writing. Rationales for the amendments were in place for all CJF projects and all but a small number of TJF projects. Although the agreements stipulated that amendments had to be in writing, we were told that in some cases amendments were based on only oral agreements with sponsors to change the terms and conditions in contribution agreements.

Payments and advances were often mishandled

11.196 In almost all projects (92 percent in TJF and 86 percent in CJF), payments were not handled properly. The deficiencies we found included one or more of the following:

- payments made for ineligible expenses ($450,000 in the 74 TJF projects that we sampled);
- payments made for expenses incurred outside the funding period specified in the agreement ($9.5 million in the 74 TJF projects, and $755,000 in the 36 CJF projects that we sampled);
- payments made without review of adequate supporting information;
- payments made to a party other than the recipient specified in the agreement;
- payments that did not respect the terms and conditions of the agreement (for example, contributions paid for salaries in the expectation that the jobs would be created after the project closed); and
- payments approved without proper authority.

11.197 In some cases, the agreement indicated that HRDC would pay the lesser of a certain amount or a certain percentage of eligible costs. However, as the total cost of the project was rarely known to HRDC, in most of these cases we were unable to conclude whether the payments had been correct.

In almost all TJF and CJF projects, payments were not handled properly.

11.198 Advance payments were used often in TJF (63 percent of projects), but less commonly in CJF (36 percent). Where advance payments were used, we found that they were not managed

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Activity and financial monitoring was insufficient in the vast majority of TJF and CJF projects.

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11.199 We noted significant peaks in TJF expenditures before year-end, especially before the closing of the program on 31 March 1999. Indeed, we saw some cases of funding provided for projects that, at the end of March 1999, were expected to be completed in just a few days. Exhibit 11.11 shows TJF expenditures by month.

11.200 In our audit we found it difficult to determine whether agreements and payments had been approved in accordance with delegated authorities. Many local offices did not have signature cards or could not confirm the level of authority of the person who had signed the agreement or the payment. In our view, this unacceptable situation was due in part to the high turnover that occurred in the last few years and to the very generic delegation chart.

Lack of project monitoring

11.201 Activity and financial monitoring was insufficient in the vast majority of projects (98 percent of TJF projects and 79 percent of CJF projects). Project officers did not prepare risk-based plans for monitoring approved projects. We could not find evidence of any activity monitoring or financial monitoring in 46 percent of TJF projects and 7 percent of CJF projects. Final financial visits had not always been completed before the last payment was issued (78 percent of TJF and 23 percent of CJF projects).

Project Results

Information on project results inadequate

11.202 The terms and conditions of both TJF and CJF required that evaluating them against their objectives include measuring their return on investment — that is, how successfully they created jobs in areas of high unemployment and generated funds from partners outside HRDC. As well, the terms and conditions required HRDC to monitor the implementation of the program and annually report the results achieved, in terms of numbers of jobs created and numbers of dollars generated from partners. Our review of departmental performance reports for the last three years indicates that the Department has

Exhibit 11.10

Advance not Cleared – Tube Fab Ltd., Machine Products Division, Prince Edward Island

This $495,000 TJF project included the expansion of the Tube Fab facility and the purchase of new equipment and machinery.

The agreement was signed on 23 March 1999 for a funding period extending from 22 March 1999 to 31 March 1999. According to the Minister's approval of the project, its activities funded under TJF had to be completed by 31 March 1999.

On 25 March a first payment of $445,000 was made – 90 percent of the approved total. This payment was an advance. A second payment for the remainder of the contribution was made on 16 April 1999 before HRDC had received the documentation required to clear the advance. This was contrary to Treasury Board policy.

Invoices on file for machinery and equipment indicate that the expenditures were made after 31 March 1999, beyond the funding period.

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On 25 March a first payment of $445,000 was made – 90 percent of the approved total. This payment was an advance. A second payment for the remainder of the contribution was made on 16 April 1999 before HRDC had received the documentation required to clear the advance. This was contrary to Treasury Board policy.

Invoices on file for machinery and equipment indicate that the expenditures were made after 31 March 1999, beyond the funding period.

Source: Analysis based on departmental records

partly complied with this requirement by publishing the number of jobs expected to be created and the funding expected from partners.

11.203 We examined how information on jobs created and leverage obtained was gathered at the project level, and whether it was reliable. We concluded that information on project results was inadequate.

11.204 The standard contribution agreement includes an obligation for the sponsor to provide to HRDC, 30 days after the project's completion and again one year later, information on the numbers and types of jobs created. Only 14 percent of TJF sponsors provided the required 30-day report, and 10 percent the 12-month report. We could not reach a conclusion on the extent of compliance by CJF project sponsors because many projects were still active at the time of our audit or had only recently been completed and had not passed the deadlines.

11.205 Project officers did not properly monitor the number of jobs created, even when it was the basis for the payment of the contribution. In most cases, officers obtained information from the employer without making a site visit. To determine the number of jobs created, project officers often relied on lists of employees working at the end of the project, without recourse to information on the jobs that had existed at its beginning. In some cases, project officers relied on lists of people hired, without information on either turnover or the duration of their employment.

Project officers did not properly monitor the number of jobs created; and information on funds leveraged from other partners was inadequate.

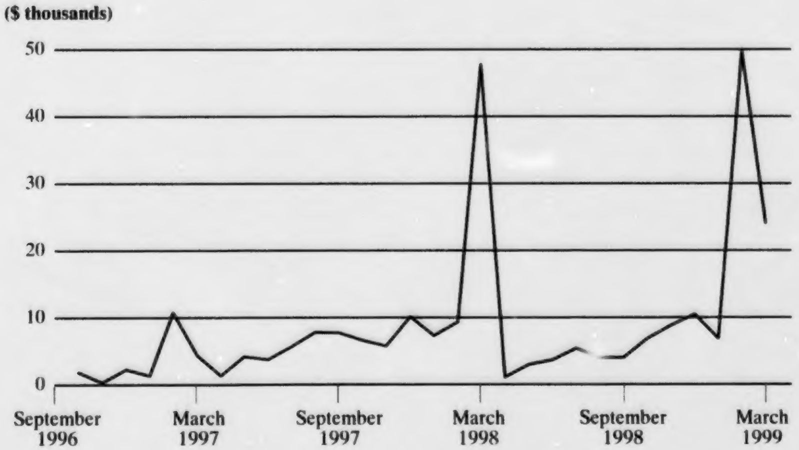
11.206 HRDC counted all the jobs created by a project, regardless of the extent of its contribution toward the project's total cost. We also found that HRDC and the federal regional development agency each counted all the jobs created by a project when both were involved in funding it.

11.207 Our audit found that the only information available on funds leveraged from other partners was based on estimates provided by sponsors with their project applications. Because the final costs of projects were almost never known to HRDC, it could not determine the actual contribution made by other partners.

11.208 In February 2000, following the release of the 1999 internal audit report, HRDC made an effort to account for all jobs created by TJF. Regional offices were asked to complete a template setting out

Exhibit 11.11

Transitional Jobs Fund – Monthly Expenditures



Source: Departmental records

the results of the program, including jobs created and leverage achieved. Telephone follow-up with sponsors and reviews of project files were used to capture the information. However, this process did not provide a constant measure of time elapsed from the end of projects. Nor did it yield any information on the actual total costs of projects and the funding provided by others.

Effectiveness Measurement and Reporting

Because the 1998 evaluation was completed early in the life of the TJF program, the Department was unable to examine adequately the sustainability of jobs associated with funded projects.

A preliminary evaluation of TJF was completed in 1998; an evaluation planned for 2000 did not proceed

11.209 A Phase I evaluation of TJF dealt with the early stages of the program's activities and was completed in October 1998. The evaluation concluded that TJF was expected to create 29,500 new jobs by the end of March 1999. The Department stated further, "It is estimated that, without TJF, 22,000 of these jobs would not have been created."

11.210 We assessed the methodology and results of the 1998 evaluation of TJF. In part because it was a preliminary evaluation, we found limitations in it. These limitations are all the more important given that a more in-depth Phase II evaluation of the program (and CJF), which was to have been carried out in 2000, did not proceed.

Limitations in the 1998 evaluation

11.211 The 1998 evaluation did not examine the adequacy of the approach to targeting program activities in local areas of high unemployment. Nor did it consider such issues as the possible displacement effects of the program, including the possibility that publicly funded subsidies had allowed some private sector firms to hire workers away from other employers. Further, the evaluation did not base its cost-per-job analysis on all federal programs involved in funding TJF projects. Because the 1998 evaluation was completed early in the life of the program, the Department was unable to estimate its impact on future Employment Insurance claims of workers hired during the program. It was also unable to examine adequately the sustainability of jobs associated with funded projects. These issues were to have been examined in the Phase II evaluation.

11.212 The Department's estimates of TJF's employment impacts were based primarily on a telephone survey of employers, which required employers to assess the program's results at the project level. The evaluation aggregated these results to represent the program as a whole. Part of our assessment of the Department's evaluation methodology included a brief telephone follow-up of some sponsors in our TJF sample. In most cases, we found that sponsors had difficulty isolating the impact of the HRDC funding either on the progress of the project itself or on the number of jobs that were created.

11.213 We concluded that because of the difficulty of measuring job creation effects, it would have been important for the Department to corroborate employers' self-assessments with other information. The 1998 evaluation clearly identified a test to corroborate the existence of TJF's job creation effects. The report noted that information on whether or not project sponsors used TJF funds as a last resort would help in measuring the program's incremental effects — that is, the extent to which the program led to the creation of jobs that would not otherwise have been created.

11.214 This test would have required assessing whether project applicants had exhausted all other financing possibilities before obtaining TJF funding. In our judgment, the test is an important one; indeed, the Department incorporated it in the operational guidelines of the subsequent CJF program. However, the Department did not examine this issue in its telephone survey of employers. It told us that it did not do so because by the time it became aware of the test, it was too late to incorporate it in the survey.

The evaluation approach resulted in an overestimate of incremental job creation

11.215 The Department focussed strongly on assessing TJF's effects in triggering projects that would not otherwise have occurred or, alternatively, in expanding projects that would have proceeded anyway without TJF funding.

11.216 The Department's telephone survey showed that some projects would have gone ahead without TJF assistance (42 percent of the projects surveyed) but that in about half of those cases, TJF had triggered an expansion of the project and of its employment creation. However, the evaluation report indicates that in measuring the incremental employment effect, all employment associated with the expanded projects was treated as incremental — not just the jobs related to the additional activity stimulated by TJF.

11.217 The result of this approach was that the incremental job creation effect of TJF was overstated as presented in the evaluation and reported by the Department to Parliament.

11.218 The Department undertook a subsequent internal study in early 2000, again based on contacts with employers. The results of this study generally supported the initial total figure of about 30,000 jobs but did not address the estimated 22,000 incremental jobs. Yet it is this latter measure that is key to judging the program's effectiveness.

We could not confirm the program's effectiveness

11.219 We sought to confirm the program's longer-term impacts. We based our analysis on the Department's estimate, derived from its program data, that over a three-year period the program's expenditures of about $300 million had leveraged almost $3 billion in project activities in the targeted areas. We also took into account the view expressed in the 1998 evaluation that TJF had the potential to bring considerable economic relief to communities experiencing high unemployment.

11.220 We assessed the links between estimates of jobs generated by projects and estimates of total project expenditures. We noted that a small number of projects exercised a strong influence on the total leverage estimates for the program, with some estimated leverage as high as $700 per dollar of TJF expenditure. In contrast, some 50 percent of projects had leverage of less than $3 per dollar of TJF expenditure.

11.221 Much of the data on total project expenditures in the Department's program database was of poor quality. Where the data appeared more reliable (in about half the projects), we found a close relationship between the numbers of jobs at the project level and the TJF contribution, even though on average TJF accounted for only about 10 percent of the funding received by a project. This finding appears to reflect HRDC's approach to funding projects while meeting administrative guidelines related to TJF cost-per-job.

11.222 However, we found that funding provided by other partners and project sponsors was of little use in explaining the number of jobs at the project level. This finding raises questions about the reliability of the information available to the Department on the leverage of funds achieved by the program.

11.223 Finally, we analyzed the program data provided to us by the Department in combination with Statistics Canada's Labour Force Survey data. While we identified a number of problems in the quality of program data, the estimated $3 billion in total project spending over three years — if it occurred to the extent claimed by sponsors in project applications — should have been of identifiable benefit to local economies and their labour markets. However, we could find no evidence that the leveraged spending estimated was associated with longer-term improvements in general employment and in unemployment conditions in the areas targeted by the program.

Concluding Comments

11.224 We found weaknesses in many aspects of the management control framework of the Transitional Jobs Fund and, to a lesser degree, the Canada Jobs Fund. In addition, we found that the measurement of results to support learning and accountability was deficient.

11.225 Many program officers and other employees told us of problems in the Department's capacity and in their own ability to deliver TJF properly. The Department acknowledged these difficulties when it specifically asked Treasury Board to provide the CJF with operating resources to help ensure its effective delivery and monitoring.

11.226 The Department delegated full responsibility for the delivery of these programs to its regions, with little central monitoring to ensure consistency and compliance with the programs' terms and conditions. Similarly, at the regional level we found little monitoring of the quality and consistency of decisions. The regional offices played a mainly advisory role and focussed on controlling the regional program budgets.

11.227 Project officers we spoke to welcome the new tools and training being developed to support them in their work. We could also see some signs of improvement in the delivery of CJF projects approved late in 1999 and in 2000. Files were better documented, agreements were more comprehensive, financial controls were stronger and projects were monitored more closely.

11.228 The Transitional Jobs Fund ended on 31 March 1999. On 22 June 2000, the Minister of Human Resources Development Canada announced that the Canada Jobs Fund would be terminated. The Minister added that all applications with business plans received in HRDC local offices by 22 June 2000 would be processed in the normal manner, but that applications received after that time would not be considered.

Youth Internship Canada

Program Description

11.229 In 1996, the youth unemployment rate was nearly double that of other age groups in the labour force. In its June 1996 report, *Take on the Future, Canadian Youth in the World of Work*, the federal task force on youth indicated that due to their lack of experience, youth face their greatest challenge in getting a first job.

11.230 Following the1996 Speech from the Throne, which outlined the employment-related difficulties faced by youth, the government announced its Youth Employment Strategy to work with partners and help young people acquire work experience that would allow a transition from school to work. As part of the Strategy, HRDC launched its Youth Employment Initiatives in 1997. Through partnerships with business, labour, industry, not-for-profit organizations, communities, and other levels of government, these initiatives were aimed at helping youth prepare for, obtain and maintain employment, thus helping them make the transition into the labour market.

11.231 In a February 1997 decision of the Treasury Board, the government approved new consolidated terms and conditions for HRDC's Youth Employment Initiatives. The Youth Internship Canada (YIC) Program is one of four main activities of HRDC's Youth Employment Initiatives. YIC is a consolidation of existing programs, under the new terms and conditions approved by the Treasury Board in its 1997 decision.

11.232 As outlined in the Treasury Board decision, the overall objective of Youth Employment Initiatives is to assist youth in preparing for, obtaining and maintaining employment, and in making a successful transition into the labour market, thereby resulting in increased employment. The aim of YIC, as outlined in the program's operational guidelines, is to help youth who are unable to get a job without assistance.

11.233 Under the program, HRDC provides contribution funds to private, public and not-for-profit organizations to develop projects that help youth enhance their skills and gain work experience through internship opportunities. YIC measures its performance by two indicators: youth employed after the internship, and youth who return to school. The program is funded through annual appropriations from Parliament; expenditures from 1997-98 to 1999-2000 are shown in Exhibit 11.12.

The aim of the Youth Internship Canada (YIC) program is to help youth who are unable to get a job without assistance.

11.234 HRDC contributions to employers or sponsor organizations subsidize the overhead and wage costs of hiring youth for internships. In some large projects, a sponsor organization is responsible for recruiting participants and placing them with employers. The participants then receive on-the-job training from employers. In a one-to-one intervention (one participant to one employer), the employer recruits the participant, receives contribution funding and provides on-the-job training. In some cases, recruitment of either sponsors or participants has been outsourced to third parties. In any case, at the end of the internship, participants are expected to either become employed or return to school. Exhibit 11.13 provides some examples of the range of projects funded by YIC.

11.235 Human Resource Centres of Canada (HRCCs) administer most YIC projects. The exceptions are some large projects administered by HRDC regional offices or headquarters.

Exhibit 11.12

Youth Internship Canada – Expenditures

Expenditures from 1997-98 to 1999-2000	
1997-1998	$ 50,073,000
1998-1999	$ 105,740,000
1999-2000	$ 74,356,000*

* Budgeted expenditures

Source: Departmental records

Program Design

11.236 The key elements of the program's design are set out in its operational guidelines. Exhibit 11.14 provides a summary of those elements.

Broad application of eligibility criteria

11.237 The program's criteria for eligibility of sponsors are broad and straightforward. We found no problems in their application.

Project officers were not given guidance on how to interpret the participant eligibility criteria.

11.238 As shown in Exhibit 11.14, YIC has three criteria for participant eligibility: individuals are normally under the age of 30 and have not made the transition into the labour market, are unemployed or underemployed, and are eligible to work in Canada. YIC places greater emphasis on youth at risk (youth facing multiple barriers to employment; for example, youth who have not completed high school, single-parent youth, Aboriginal youth and street youth). However, other youth having difficulty making the transition to employment are also able to participate. Based on these criteria, a broad range of individuals could qualify.

11.239 We found that some project officers imposed less stringent requirements than others in selecting projects for funding. In some cases, new graduates from colleges and universities were assisted. In others, only those facing multiple barriers were considered. The Department told us that in part this reflects regional diversity among labour markets.

11.240 We noted that project officers were not given guidance on how to interpret the participant eligibility criteria to ensure their consistent application — for example, guidance on the definition of underemployment and the evidence needed to indicate an inability to get a job without assistance. In our view, this guidance is particularly important in a program such as YIC, where selecting youth who need no assistance may provide better apparent results (when measured in terms of retained employment) than

Exhibit 11.13

Youth Internship Canada Projects – Examples

1. A small project (up to $10,100)

A small company needs a delivery driver for its operations. Funds are requested by the company to help pay for wages to hire an unemployed youth for a three-month internship as a delivery driver. The youth's experience with the company should result in increased skills and work experience to help the participant gain employment. HRDC's contribution amounts to 40 percent of the wage costs, with the employer contributing 60 percent.

2. A large project (over $10,100)

A non-profit social service organization wants to provide skills development and work experience in business entrepreneurial skills to unemployed or underemployed youth who are recent Canadians having difficulty making the transition into the Canadian labour market. The organization provides a program designed to enable young entrepreneurs from all ethnic and cultural backgrounds to develop the skills they need in order to establish and operate a small business. HRDC's contribution pays for almost all program costs, which include staff wages, overhead, course costs and income support for participants. Other contributions, including in-kind contributions, are to be provided by community professionals. This project will provide six-month internships to more than 30 youth participants.

3. A high-value project (over $606,000)

A retail store dealership association wants to create a large complement of first time job entrants. The project will provide internships to unemployed or underemployed youth, including those in the rural areas, to acquire basic customer service and entry-level selling skills. These skills should be transferable to future employment opportunities. HRDC's contribution (33 percent) funds wage and overhead costs for the project. This project will provide about 1,000 internships.

Source: Departmental records

selecting youth who are having difficulty making the transition to employment.

11.241 Exhibit 11.15 describes a case where the project did not clearly meet the program's overall aim of helping youth who are unable to get a job without assistance.

Some limitation in content of promotional information

11.242 HRDC disseminates information on YIC in several ways. At national headquarters, the Department developed documentation (fact sheets, an overview pamphlet) providing program information, primarily to prospective sponsors and employers. HRDC's Web sites also provide information on its youth initiatives, including YIC. In addition, a 1-800 information line responds to enquiries about youth programs.

11.243 We found some limitations in the content of the promotional material. Documents provide generic information about the program to prospective sponsors, employers and participants, but they do not include information such as the expected results of the program (become employed or return to school), target groups (youth at risk) and more specific eligibility requirements for participants (including a definition of "underemployment"). The documents direct youth and prospective sponsors to local HRCCs for additional information.

Project Selection and Approval

Lack of rationale to support selection and recommendation for approval

11.244 For each YIC project, we expected to find something on the project file that constituted a request to HRDC for the contribution — including information on the activities to be carried out over a specified period of time, the amount of funding requested, and the results to be achieved. For the larger projects, we expected that applicants would submit a proposal with their application. We did not expect to find as much information on small projects, but we did expect to find at least a letter from the applicant setting out the key information.

11.245 We also expected to find an assessment of the request for funding completed by the HRDC project officer, and a signed recommendation (with accompanying rationale) for approval. We expected that the rationale for recommending approval would indicate how the project would contribute to achieving the program's objectives. Again, we expected that the depth of supporting analysis would vary with the size and complexity of the proposed project.

Exhibit 11.14

Youth Internship Canada – Key Elements

Program Aim	**To help youth who are unable to get a job without assistance**
Success Indicators	**Youth clients employed (includes self-employed)** **Youth clients return to school**
Eligibility Criteria for Sponsors	**Private, public and non-governmental organizations**
Eligibility Criteria for Participants	**Unemployed or underemployed youth (normally under the age of 30) who have not made the transition into the labour market** **Legally entitled to work in Canada** **Emphasis on assisting the needs of youth at risk (youth facing multiple barriers to employment)**

Source: HRDC Youth Employment Initiatives Operational Guidelines, August 1998

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Source: Departmental records

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11.245 We also expected to find an assessment of the request for funding completed by the HRDC project officer, and a signed recommendation (with accompanying rationale) for approval. We expected that the rationale for recommending approval would indicate how the project would contribute to achieving the program's objectives. Again, we expected that the depth of supporting analysis would vary with the size and complexity of the proposed project.

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Source: HRDC Youth Employment Initiatives Operational Guidelines, August 1998

11.246 Our review found several deficiencies:

- An application, a proposal or other documentation was missing for nearly half of the small projects (up to $10,100) and 38 percent of the larger projects (over $10,100). It is not clear in those cases whether sponsors applying for YIC funding had submitted any documentation to support their requests.
- Reflecting the limited documentation of the funding requests, we found a frequent lack of assessment or analysis by HRDC project officers to support their recommendations to approve project funding. In only five percent of the larger projects was there evidence that proposals had been assessed or analyzed. In 82 percent of the small projects, no rationale was provided for why the project should be funded.
- We found no indication that the possible need for an environmental assessment had been considered or that any sponsors had been checked to see whether they had debts outstanding to HRDC.
- Furthermore, we found that in 40 percent of the larger projects and 56 percent of the smaller projects, the project officer had not signed or dated the recommendation for approval.

In only five percent of the larger YIC projects was there evidence that proposals had been assessed or analyzed.

11.247 A supporting rationale for recommending approval, including an explanation of how the project will support the program's objectives, would help provide assurance to those approving the project that program funds will be used for the specific purposes intended.

Deficiencies in the project approval process

11.248 We expected to find that persons with appropriate authority had approved the projects. We found that 30 percent of the larger projects and over half of the smaller projects had no approvals on file. Of the remainder, 89 percent of the larger projects had been approved by persons with delegated authority, as had 82 percent of the smaller projects.

11.249 We also expected to see a clear assignment and acceptance of responsibility for decision making. In some cases, where recruitment of potential sponsors or participants had been outsourced to third parties, we found that it was the third-party representative who had signed the formal recommendation for approval. This was the responsibility of HRDC officials.

Exhibit 11.15

Inconsistent With Program's Aims – UBI Soft Divertissements Inc., Montreal, Quebec

In this project, YIC funds were used to assist an employer in the computer software industry to expand operations in Canada. HRDC agreed to provide a 33.3 percent wage subsidy to assist in creating about 120 jobs; this represented a financial commitment of $2.3 million. Other proposed funding for the project included $1.2 million from the provincial government.

In discussions with regional HRDC officials, we questioned whether this project fully met the YIC eligibility criteria. HRDC officials told us that because of the limited availability of other program alternatives to the Department, the YIC program had been used as part of a financial package to assist an employer to expand into the local area.

In our judgment, the primary focus of this project was on economic development and job creation, rather than on providing needed assistance to youth facing difficulties in making the transition into the job market.

In the Department's view, the records demonstrate that participants in this project met the eligibility criteria of being unemployed or underemployed.

We could find no evidence in the project documentation that individuals selected for assistance were experiencing "transition" problems. Neither was there any assessment on the project file to indicate how internships under the program would help the participants.

Source: Analysis based on departmental records and interviews with HRDC staff

11.250 We also found one large project whose approval was not based on the established procedures (see Exhibit 11.16). Although the Department requires applications and proposals to be submitted to the local HRCC, in this case the request for funding was made direct to the Minister's office. We found no evidence of an assessment against criteria having been completed to support the recommendation for ministerial approval.

Financial Management and Control

Lack of consistency in contribution agreements

11.251 Contribution agreements were in place for all projects, and persons with the appropriate delegated authority had signed them. However, there was a lack of consistency in the agreement templates used across the YIC program. Some projects used the agreement template of Youth Employment Initiatives, but many used agreements designed for other programs, such as Targeted Wage Subsidies, Job Opportunities for Youth, and the Canadian Jobs Strategy. This resulted in terms and conditions that differed among contribution agreements, for no apparent reason. For example, we found that in some agreements there was no reference to such standard provisions as those relating to conflict-of-interest codes and the need to repay debts owed to the Department.

11.252 Where agreements were amended, most amendments were supported by appropriate rationales.

Exhibit 11.16

Approval Not Based on Established Procedures - The 1999 Brott Music Festival, Hamilton, Ontario

In February 1999, HRDC approved funding of $750,000 to support the 1999 Brott Summer Music Festival in Hamilton for the National Academy Orchestra. The Brott Music Festival received $300,000 in funding from HRDC in 1997, $450,000 in 1998 and $750,000 in 1999. The 1999 Music Festival received additional funding of about $534,000 from other sources, including Heritage Canada and various non-federal partners.

The project's purpose was to prepare young orchestral musicians from across Canada to enter the field of professional music. The expected outcome was that a minimum of 75 percent of the 45 participants would find and keep full-time employment in orchestral music.

Information on file shows that a letter of request for funding was sent to the Minister's office on 7 October 1998. The project files contain no record of assessment against eligibility criteria. A 25 January 1999 recommendation for approval from HRDC's Ontario regional office notes, "This is a pan-Canadian project which received ministerial approval upon direct request from the sponsor." The Minister signed the approval on 1 February 1999.

Information in project files indicates that regional and local HRDC officials have consistently been of the view that this project does not meet eligibility criteria as it does not create permanent employment and provides only limited experience for participants. Follow-up of the 1999 project by project officers indicated that a quarter to a third were repeat participants, having been involved in previous music festivals funded in part by HRDC. The follow-up also indicated that most of those who had completed the program were either freelancing or self-employed.

The project was funded again the next year. In October 1999, the sponsor sent a letter of request to the Minister's office for funding of $791,700. Upon request, the sponsor submitted a proposal for assessment by HRDC headquarters officials, who recommended funding of $460,000 with new stipulations to limit the cost per participant and overhead costs. However, although headquarters' analysis indicated that only first-time participants would be eligible, this requirement was not included in the terms and conditions of the contribution agreement. In June 2000, the Minister approved the recommended funding.

The Department told us that the issue of repeat participants for the 2000 project will be addressed through regular monitoring.

Source: Analysis based on departmental records and interviews with HRDC staff

11.246 Our review found several deficiencies:

- An application, a proposal or other documentation was missing for nearly half of the small projects (up to $10,100) and 38 percent of the larger projects (over $10,100). It is not clear in those cases whether sponsors applying for YIC funding had submitted any documentation to support their requests.
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Inconsistent With Program's Aims – UBI Soft Divertissements Inc., Montreal, Quebec

In this project, YIC funds were used to assist an employer in the computer software industry to expand operations in Canada. HRDC agreed to provide a 33.3 percent wage subsidy to assist in creating about 120 jobs; this represented a financial commitment of $2.3 million. Other proposed funding for the project included $1.2 million from the provincial government.

In discussions with regional HRDC officials, we questioned whether this project fully met the YIC eligibility criteria. HRDC officials told us that because of the limited availability of other program alternatives to the Department, the YIC program had been used as part of a financial package to assist an employer to expand into the local area.

In our judgment, the primary focus of this project was on economic development and job creation, rather than on providing needed assistance to youth facing difficulties in making the transition into the job market.

In the Department's view, the records demonstrate that participants in this project met the eligibility criteria of being unemployed or underemployed.

We could find no evidence in the project documentation that individuals selected for assistance were experiencing "transition" problems. Neither was there any assessment on the project file to indicate how internships under the program would help the participants.

Source: Analysis based on departmental records and interviews with HRDC staff

11.250 We also found one large project whose approval was not based on the established procedures (see Exhibit 11.16). Although the Department requires applications and proposals to be submitted to the local HRCC, in this case the request for funding was made direct to the Minister's office. We found no evidence of an assessment against criteria having been completed to support the recommendation for ministerial approval.

Financial Management and Control

Lack of consistency in contribution agreements

11.251 Contribution agreements were in place for all projects, and persons with the appropriate delegated authority had signed them. However, there was a lack of consistency in the agreement templates used across the YIC program. Some projects used the agreement template of Youth Employment Initiatives, but many used agreements designed for other programs, such as Targeted Wage Subsidies, Job Opportunities for Youth, and the Canadian Jobs Strategy. This resulted in terms and conditions that differed among contribution agreements, for no apparent reason. For example, we found that in some agreements there was no reference to such standard provisions as those relating to conflict-of-interest codes and the need to repay debts owed to the Department.

11.252 Where agreements were amended, most amendments were supported by appropriate rationales.

Exhibit 11.16

Approval Not Based on Established Procedures – The 1999 Brott Music Festival, Hamilton, Ontario

In February 1999, HRDC approved funding of $750,000 to support the 1999 Brott Summer Music Festival in Hamilton for the National Academy Orchestra. The Brott Music Festival received $300,000 in funding from HRDC in 1997, $450,000 in 1998 and $750,000 in 1999. The 1999 Music Festival received additional funding of about $534,000 from other sources, including Heritage Canada and various non-federal partners.

The project's purpose was to prepare young orchestral musicians from across Canada to enter the field of professional music. The expected outcome was that a minimum of 75 percent of the 45 participants would find and keep full-time employment in orchestral music.

Information on file shows that a letter of request for funding was sent to the Minister's office on 7 October 1998. The project files contain no record of assessment against eligibility criteria. A 25 January 1999 recommendation for approval from HRDC's Ontario regional office notes, "This is a pan-Canadian project which received ministerial approval upon direct request from the sponsor." The Minister signed the approval on 1 February 1999.

Information in project files indicates that regional and local HRDC officials have consistently been of the view that this project does not meet eligibility criteria as it does not create permanent employment and provides only limited experience for participants. Follow-up of the 1999 project by project officers indicated that a quarter to a third were repeat participants, having been involved in previous music festivals funded in part by HRDC. The follow-up also indicated that most of those who had completed the program were either freelancing or self-employed.

The project was funded again the next year. In October 1999, the sponsor sent a letter of request to the Minister's office for funding of $791,700. Upon request, the sponsor submitted a proposal for assessment by HRDC headquarters officials, who recommended funding of $460,000 with new stipulations to limit the cost per participant and overhead costs. However, although headquarters' analysis indicated that only first-time participants would be eligible, this requirement was not included in the terms and conditions of the contribution agreement. In June 2000, the Minister approved the recommended funding.

The Department told us that the issue of repeat participants for the 2000 project will be addressed through regular monitoring.

Source: Analysis based on departmental records and interviews with HRDC staff

Deficiencies in the financial management of small and large projects

11.253 Youth Internship Canada is a contribution program. The payment of federal funds is therefore dependent on the meeting of performance conditions and on compliance with the terms and conditions of the contribution agreements. This requires appropriate financial management and controls, including claims from sponsors to support the payments made, review of appropriate information to support the approval of payments, and approval of payments provided in accordance with the requirements of the *Financial Administration Act.*

Project payments were not handled properly in almost 60 percent of YIC projects.

11.254 We found that project payments were not handled properly in 60 percent of the smaller projects and 58 percent of the larger projects. These included payments that were not based on claims, expense claims that were not reviewed and certified by appropriate officers, and expenditures that were reimbursed without evidence that supporting information had been reviewed.

11.255 Advances were made to 70 percent of larger projects. In 28 percent of these projects, we found deficiencies in the handling of advances. These included advances that were not in accordance with cash flow forecasts. In addition, funds continued to be advanced to some projects even though the actual expenditures or claims were well below the amounts already advanced. Where large amounts were advanced — in a departure from the Treasury Board policy — the interest due the Crown was not accounted for. We also found cases where money was advanced inappropriately at year-end, apparently to avoid lapsing the funds. Our analysis of monthly YIC expenditures shows a spending increase in March of each fiscal year from 1997-98 to 1999-2000 (see Exhibit 11.17).

Activity and financial monitoring was not systematic or rigorous

11.256 In the larger projects, we expected to see rigorous and systematic monitoring of projects, in accordance with monitoring plans based on assessed risk. We expected monitoring to include activity and financial components — activity monitoring to ensure that the project was achieving planned results and was likely to conclude successfully, and financial monitoring to ensure that funds were being spent according to the terms and conditions of the agreement. We also expected proper documentation of on-site monitoring visits. In smaller projects, we did not expect to see anything more than off-site review of relevant documentation.

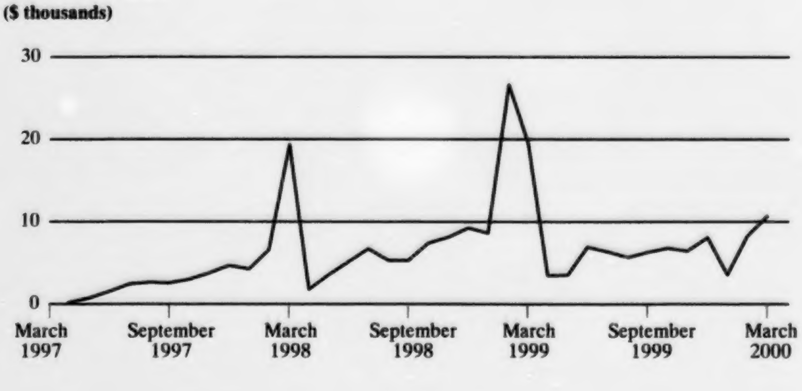
11.257 We found that:

- almost none of the larger projects had monitoring plans;

Exhibit 11.17

Youth Internship Canada – Monthly Expenditures

1997–98 to 1999–00



Source: Departmental records

- on-site monitoring (consultation with sponsors, review of financial records and books) was not evident in 62 percent of the larger projects, and 29 percent of those did not show evidence of even off-site monitoring (review of progress and activity reports, correspondence, records of telephone calls); and

- only half of the smaller projects had evidence of off-site monitoring.

On-site monitoring was not evident in 62 percent of larger YIC projects, and 29 percent of those did not show evidence of even off-site monitoring.

Project Results

11.258 Information on the performance of projects is needed to draw lessons for future project selection and to provide a basis for accountability within the Department and beyond.

11.259 YIC measures its success by two indicators — namely, youth clients who are employed after the internship, and youth clients who return to school. We expected to see information on actual results against planned targets documented in each project file.

Limited information on results against targets

11.260 Planned results of projects were generally defined in measurable terms (that is, the number of participants expected to acquire employment as a result of the internship or expected to return to school). However, the information on actual results was limited. In 59 percent of larger projects and 86 percent of smaller projects, the project files did not record actual results. For 58 percent of larger projects, we also found such information was missing from the departmental information system that, among other things, records the results of projects. Where results were available in the information system, they were not consistent with those in the project files. Furthermore, project officers told us that they did not have ready access to integrated information in the Department's information systems to help them manage their projects.

Information on project results was limited — 59 percent of larger YIC projects and 86 percent of smaller projects had no record of actual results in project files.

11.261 Information on results needs to be input regularly to departmental information systems. Project officers also require on-line access to information to track the project's status and performance. Many told us that an integrated system is needed to collect and disseminate performance information as well as financial information for sharing at local, regional and national levels.

11.262 We were concerned to find that in three cases among the seven high-value (over $606,000) projects we reviewed, information on results achieved was not recorded in the project file. Further, in one of these cases the departmental information system had no information on results (see Exhibit 11.18).

Effectiveness Measurement and Reporting

Recently completed evaluation shows some positive results

11.263 A program evaluation of Youth Internship Canada was completed in August 2000. The evaluation reported some positive findings. Compared with a matched group that had not participated in the program, program participants recorded increased employability and earnings in the year following their participation. Employability was reported up by 11 percentage points and annual earnings up by about $3,000.

A recent evaluation shows that the YIC program participants recorded increased employability and earnings in the year following their participation.

11.264 A large majority (85 percent) of participants indicated that in the month preceding their internships they had been very interested in finding full-time employment. However, 68 percent of participants said they could have found employment without participating in the internship, and 49 percent said they could have found a job closely related to their career goals. Of the 37 percent who had been employed in the week immediately before the internship, 62 percent

considered themselves to have been underemployed.

11.265 The evaluation also reported that 79 percent of the participants met at least one of the following conditions for program assistance:

- did not graduate from high school;
- were unemployed immediately prior to the program; or
- considered themselves to have been underemployed in the week prior to the internship or in the previous 12 months.

Project officers faced several challenges — including direction, supervision and training.

11.266 The evaluation's approach was based on analysis of a comparison group. The survey of the comparison group showed a lack of awareness about the availability of the YIC program. Only 19 percent said they were aware, or somewhat aware, of the program. This figure is consistent with our observations on limited promotional information (paragraphs 11.242 and 11.243).

11.267 We reviewed the approach used in the evaluation and concluded that it was sound. However, our audit identified two key areas that we believe deserve to be addressed more explicitly in future evaluations:

- whether the program's current procedures ensure equal access to program assistance by eligible youth clients and sponsors; and
- negative unintended effects when the program is used to provide employers with the financial benefits of wage subsidies rather than to provide assistance to youth having difficulties in the labour market.

Issues at the field level

11.268 As part of our audit, we interviewed project officers and others involved at the field level in delivering YIC as well as other grant and contribution programs. Several challenges faced by project officers surfaced in these discussions.

- **Downsizing and devolution.** When the Department was downsized and programs and services were devolved to the provinces and other organizations, many project officers left the Department. There was a corresponding loss of corporate memory and experience. Experienced project officers were sometimes replaced by displaced counsellors who had little or no experience in project management.

Exhibit 11.18

Information on Results – High-Value Projects

Saskatchewan Indian Training and Assessment Group Inc. (over $1.1 million)

This project was to assist 112 First Nations' youth who were out of school and unemployed to make the transition from school to work, by providing them with relevant work experience and personal and work-related skills development. The project was to be completed over a seven-month period from 1 September 1998 to 31 March 1999. The results achieved by this project were not recorded on file or in the departmental information system.

UBI Soft Divertissements Inc. (over $2.3 million)

HRDC provided a wage subsidy to a computer software company over an 11-month period to March 1999 to assist 242 participants and to create about 120 full-time jobs. However, there is no information in the project file on how many youth attained full-time employment or returned to school. The departmental information system shows only that 180 were employed.

Public Technologies Multimedia Inc. (about $740,000)

This project was to create permanent employment for 79 youth who had formal training in multimedia but needed practical experience. The project was completed in June 1999, but there is no information in the project file on how many youth found permanent employment as a result of the YIC intervention or returned to school. The departmental information system shows only that 73 youth were employed.

Source: Analysis based on departmental records

considered themselves to have been underemployed.

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- did not graduate from high school;
- were unemployed immediately prior to the program; or
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Source: Analysis based on departmental records

- **Direction from regional offices.** Many program officers at regional offices also left. In some cases, regional officers were not available to provide advice to local HRCC project officers. Where advice was given, we were told that it was not always consistent.

- **Lack of supervision.** Also as a result of downsizing, the manager level was eliminated. This was intended to result in "empowerment" to work as teams on resolving problems. However, it left some project officers without day-to-day support, as directors were not always available to provide detailed guidance. The lack of direction and leadership only left project officers more frustrated when they were unable to resolve problems.

- **Training.** In general, there was no mandatory training for project officers, including those without project management experience. Project officers often had to learn on the job from unofficial mentors or more experienced project officers and ad hoc training. Some of them indicated that poor practices had continued as a result.

- **Systems support.** Information systems were not integrated to provide overall project information. Information on project status was available only through regional offices. Although local HRCC project officers input the data, they had no access to integrated information. Because project officers lacked integrated information to help manage their projects, they had to develop local systems — a duplication of effort.

- **Administrative support.** Project officers indicated that they needed more clerical and administrative support to carry out routine tasks so they could devote more effort to managing and monitoring projects and could engage in the community networking that the program requires.

11.269 Many project officers told us that the 1999 internal audit had had some positive effects. They felt that their jobs were now perceived as more important, and they were looking forward to receiving more training. However, they were also frustrated with the workload that resulted from the Department-wide file review. In some cases, they had to put applications on hold until the file review was over. Some project officers were demoralized because they feared that they would lose some of their responsibilities, and some feared impending changes that could result in restructuring and reclassification of their jobs. More important, they felt they were being blamed for the mismanagement of grants and contributions, when in many cases it had been beyond their control.

Concluding Comments

11.270 We concluded that there were significant weaknesses in the management control framework for Youth Internship Canada in the period up to December 1999. Assessments of funding requests, which would have served as a sound basis for selecting the projects most likely to achieve the program objectives, were frequently missing. There were serious deficiencies in the financial management and control of projects, including lack of compliance with Treasury Board policy and requirements of the *Financial Administration Act*. In a large proportion of cases, project payments and advances were not handled properly and projects were not monitored adequately.

11.271 Planned project results were generally defined in measurable terms, but in many YIC projects, information on results was not on file or was otherwise not available. An evaluation of the program was completed in August 2000 and it reported some positive results. We concluded that the methodology used in the evaluation was sound.

Action to address the deficiencies

11.272 We audited YIC projects that had been completed by the end of December

1999. Therefore, we did not expect to see the effects of the corrective action the Department took under its Six-Point Action Plan and under other initiatives following its 1999 internal audit. However, our assessment is that the corrective action the Department has taken and plans to take addresses the deficiencies we found in our audit of YIC projects. We report the results of our detailed examination of the Department's corrective action in Part I of this chapter.

Social Development Partnerships

Program Description

11.273 The Social Development Partnerships Program (SDPP) is a research and development program that supports activities of the social not-for-profit sector. The program comprises several subprograms that provide funding to volunteer social service organizations and disability organizations assisting disadvantaged individuals.

11.274 The SDPP provides funding to projects that develop and test models designed to improve individuals' capacity for full participation in society and to strengthen related services provided in communities. The program also funds projects that develop and distribute information to client groups and key decision-makers at the policy, program development and delivery levels. Finally, SDPP provides organizational support funding for specified periods of time to selected national volunteer organizations that support activities consistent with HRDC's mandate.

11.275 The SDPP uses grants as well as contributions. Most of the support it delivers is in the form of contributions to projects that focus on developing social service models and delivery or developing capacity in the voluntary sector to represent marginalized and vulnerable communities and provide them with social services. Grants are provided to help national social service and national disability organizations build their capacity to promote their members' interests.

11.276 The total program expenditure on grants and contributions in 1998-99 was $14.4 million ($5 million in grants and $9.4 million in contributions). The budget for 1999-2000 was $15.1 million ($5.6 million in grants and $9.5 million in contributions).

Program Design

11.277 In February 1998, the Treasury Board approved the terms and conditions of the Social Development Partnerships Program. The terms and conditions identify activities and classes of recipients that are eligible for funding support. In addition, they outline provisions dealing with eligible expenses, maximum funding support and methods of payment, along with standard requirements for audit, evaluation, and accountability.

11.278 These new terms and conditions consolidated and streamlined the elements of the various program authorities that had previously existed under other federal departments. Until 1993, the National Welfare Grants program operated within the Department of National Health and Welfare; the Disabled Persons Participation Program was under the mandate of the Department of the Secretary of State. With the reorganization of government in 1993, these programs fell under the mandate of Human Resources Development Canada.

11.279 Many of the projects we examined in our audit had begun under these previous programs and continued to operate under the related authorities and guidelines, rather than the terms and conditions approved for the SDPP in 1998.

The Social Development Partnerships Program (SDPP) supports activities of the social not-for-profit sector. It uses grants as well as contributions.

Reasons for using either a grant or a contribution are not clear

11.280 We found that the program's terms and conditions do not clearly identify situations where a grant would be more appropriate than a contribution. We noted, for example, that building a community's capacity to meet social development needs was funded through contribution agreements. At the same time, building an organization's capacity to assist the disadvantaged was funded with grants. The reasons for this difference are not clear.

11.281 Because grants are unconditional payments, they involve less stringent requirements for accountability (see Part I of this chapter, paragraph 11.13). We therefore believe that grants need to be reserved for situations where it is demonstrably appropriate for transfer payments to be unconditional. The program material provided in response to our specific questions did not contain any information on the rationale for using grants instead of contributions in any of the activities under this program.

Operational guidance to project officers is lacking

The SDP program's terms and conditions describe eligible activities in very broad terms.

11.282 While classes of eligible recipients are clearly identified in the program's terms and conditions, eligible activities are described only in very broad terms. For example, the terms and conditions state, "Activities eligible for support under the program include a wide range of pursuits and include, but are not limited to, applied research, development, and capacity building." The statement is essentially open-ended, with no clear limits on activities that can be funded. HRDC officials told us that the eligibility criteria were intentionally formulated to be broad because of the inherent difficulty of defining concepts such as community capacity, as well as the desire to allow for negotiation with project applicants.

11.283 Except for the program's formal terms and conditions, the only guidance available to project officers is contained in guides for project applications. These tell applicants how to make project proposals and submit applications. In our view, the guides are not adequate substitutes for operational guidance aimed specifically at helping those who administer the program, partly because they do not cover the range of administrative issues involved. This was confirmed in our detailed discussions with project officers about the contents of individual project files and related program activities.

11.284 The project application guides refer to additional "funding priorities". For example, one of the funding priorities relates to "social services or social development projects that target vulnerable populations and are national in scope"; these include "research, public education, successful models, pilots, advocacy, and conferences." Key concepts are mentioned, such as social services and social development, but are not clarified. The guide for project applications by national organizations states, "Projects need to be…consistent with HRDC guidelines and limitations" — but it does not make clear what these guidelines and limitations are.

11.285 While we recognize the need to maintain a degree of flexibility, we believe that operational guidance directed specifically to project officers would help ensure that eligibility criteria are applied with discernment to achieve program objectives.

Program objectives are not defined in terms of results

11.286 The program's terms and conditions include a statement of its objectives. The SDPP is described as a research and development program that supports activities to identify, develop and promote nationally significant best practices and models of service delivery. In addition, the program aims to build community capacity to meet the social development needs and aspirations of populations that are or may be at risk.

11.287 The description of program activities is part of the objectives, and the objectives therefore suffer from the same lack of clarity as the eligibility criteria. We expected that HRDC would have defined the broad program objectives further, in terms of outcomes and measurable results. However, it has not done so.

11.288 The terms and conditions state that the objectives are to be achieved through a review and accountability framework, and in partnership with the volunteer sector. We expected that a framework would have been developed as a first step in the program's operation, providing more detailed, concrete implementation guidelines and performance indicators.

11.289 The Treasury Board asked HRDC to report, within two years after the date of approval of the terms and conditions, on the appropriateness of accountability measures developed for the grants portion of the program. At the time of our audit, the Department's response to this request was overdue. The Department told us that it intends to establish and report on accountability measures as part of developing and implementing an evaluation framework for the SDPP. Preliminary work on developing that framework was under way when we completed our audit.

Program marketing is informal

11.290 The program is promoted through the Internet and by a network that includes provincial governments, national client organizations and the academic community. As noted, application guides have been developed for each of the SDPP subprograms, describing how potential applicants can apply for financial support. For some subprograms, the Internet site includes the guides; for others, an address and telephone number are provided for further information.

11.291 The predominant characteristic of the program's marketing framework is the informality of much of the activity. For example, we heard in our discussions with project officers that some potential applicants had been invited informally to submit applications for specific projects. Sometimes this followed joint consultative seminars, particularly when projects involved research, development and testing. In our view, this informal approach to marketing does not provide adequate assurance that all eligible clients have equal access to the program.

11.292 At the time of our audit, public information about eligibility for SDPP organizational funding was inconsistent and had the potential to reduce access to that funding. This inconsistency has been rectified.

Preliminary work on developing an evaluation framework was under way when we completed our audit.

Contributions — Selecting and Approving Projects

Proposals inadequate in almost one third of projects

11.293 We concluded that just under one third of project proposals (29 percent) were inadequate; for 16 percent of the projects there was no proposal on file. Where proposals had been received, some lacked key information needed to proceed with a realistic assessment.

No record of assessments for most projects

11.294 We expected that appropriate procedures would be established to ensure that project applications and proposals recommended for approval were those that met the eligibility criteria and were the most likely to achieve the program's objectives. We expected that once established, these procedures would be documented and followed. The Department informed us that officer-level committees conducted assessments and reviews, and we found some indications of an assessment process. However, the files on 85 percent of projects showed no assessments of any kind. This is an important omission: it means that the expenditure of public funds was authorized without any record of how the projects met the eligibility requirements.

The files on 85 percent of SDPP projects showed no assessments of any kind.

11.295 Even where assessments were on file, we had concerns about their adequacy:

- some 58 percent of the assessments did not explicitly address criteria for program eligibility and project selection;

- similarly, 58 percent of the assessments did not assess the reasonableness of estimated project costs; and

- with few exceptions, checks of sponsors for other contracts with HRDC, including any amounts owed to the Department, were not conducted.

11.296 All project files contained recommendations for approval by the Minister. However, those recommendations were not supported by any rationale in 94 percent of the projects.

Contributions — Financial Management and Control

Contribution agreements frequently lacked key information

11.297 The contribution agreements signed by the Department and the project sponsors are important documents because they identify the details of the performance requirement and the conditions that are to be met in order for the sponsor to be reimbursed for eligible expenditures.

Appropriate signing authorities for contribution agreements were respected in all cases.

11.298 We found that appropriate signing authorities for contribution agreements were respected in all cases. However, we identified several concerns about the agreements themselves:

- although all projects had signed agreements in place, one in five agreements did not include the necessary schedules (these schedules contain important information on performance requirements and budget details);

- key information on allowable expenses was missing from all agreements. Although the agreements make reference to the program's terms and conditions (which clearly identify eligible expenses), those terms and conditions were not always available to project sponsors; and

- a small proportion of agreements did not include an exact date for the project's start or end.

11.299 Forty-five percent of the agreements were amended to reflect a change in either the project's budget or its duration. Most amendments were supported by rationales and in all cases were approved by persons with the necessary authority.

Deficiencies in handling payments and advances

11.300 We expected that financial and management control of program expenditures would comply with relevant government policies and legislation. In this respect, we identified a number of serious deficiencies.

11.301 In 30 percent of projects, payments were made that were not based on claims. In addition, payments were not always supported by a review of appropriate information (proof of expenditures). In 21 percent of projects, final payments were approved before final claims or final project reports had been received. However, in all projects, staff with the appropriate delegated authority approved payments.

In 93 percent of SDPP projects where advances were made, they were not handled appropriately.

11.302 Advances were made to 63 percent of projects; in 93 percent of those cases, we found that the advances were not handled appropriately. Problems included advance payments that did not correspond to cash flow forecasts or that exceeded the maximum amount allowed by the agreement, and a lack of appropriate accounting for interest earned on advances.

Inadequate project monitoring

11.303 We expected that approved projects would be monitored appropriately and reported on the basis of an assessment of the risks involved. We expected to see monitoring systems in place to identify and report on a timely basis on progress and emerging problems.

11.304 We concluded that monitoring had not been adequate in 97 percent of contribution projects. We found almost no evidence that financial or activity monitoring had been carried out.

Contributions — Project Results

Information on results was inadequate in half the projects

11.305 We expected to see adequate performance measurement procedures in place, in keeping with HRDC's approach to "managing for results" and in keeping with the requirement to account for results achieved with the funds approved by Parliament. However, we found that results at the level of individual projects were not being tracked adequately.

Results at the level of individual SDPP projects were not being tracked adequately.

11.306 Information on the results of half of the projects was missing or inadequate. In almost all of these cases, project activity reports were not submitted as required by the provisions of the contribution agreement. In addition, in 32 percent of these projects we found no evidence on file that HRDC had received a final project report.

Grants — Project Selection and Approval

Grant proposals not assessed in all cases

11.307 With one exception, all grant proposals were on file. The large majority of files (80 percent) included the information needed to assess the project against the eligibility and selection criteria. However, 58 percent of the files contained no clear evidence that proposals had been assessed before they were recommended for approval.

11.308 Among those that had been assessed, we had a number of concerns about the adequacy of the assessments. For example, assessments did not explicitly address all eligibility criteria; they did not address the reasonableness of the amount requested; and they did not include a check on recipients for other contracts with HRDC and any amounts they may still have owed the Department.

No rationales for recommending the approval of projects

11.309 All recommendations for approval of the grant applications were on file and the Minister had approved all the grants, as required. However, in no case was a rationale provided for recommending that the grant application be approved.

Grants — Financial Management and Control

Grant payments were made appropriately

11.310 Persons with the appropriate delegated authorities approved all grant payments. We found also that grants were paid in compliance with Treasury Board policy, which requires a certain minimum number of instalments, depending on the total amount of the grant.

Grants were paid in compliance with Treasury Board policy.

Improvement needed in reviews to determine continued eligibility

11.311 According to the terms and conditions set by the Treasury Board, each grant can be approved for a period of up to three years, subject to an annual review to determine continued eligibility. We identified several areas that required improvement. There was a lack of evidence that reviews were conducted on an annual basis, as required. When evidence of reviews was on file, we found that the reviews did not adequately address all of the eligibility and selection criteria. Finally, 42 percent of the grant recipients failed to submit complete reports substantiating their continued eligibility.

Effectiveness Measurement and Reporting

11.312 Over and above the required tracking of ongoing performance at the project level, program evaluation is intended to provide a longer-term perspective on the results of the program overall and on the achievement of program objectives.

The program has not been evaluated

11.313 The Social Development Partnerships Program has not been formally evaluated to date. Program management has undertaken some preliminary work, identifying the activities of the organizations that SDPP assists, and assessing their linkages to the program's objectives.

11.314 During our audit, program management made arrangements with the Department's Evaluation and Data Development Branch to prepare an evaluation framework for this program. The work is scheduled for the current fiscal year, and preliminary work had begun when we completed our audit. We believe it is important that the evaluation framework include an examination of the rationale for apportioning program expenditures between grants and contributions (see paragraphs 11.280 and 11.281).

Concluding Comments

11.315 We concluded that there were deficiencies in the management control framework of the Social Development Partnerships Program in the period up to December 1999. These weaknesses were more serious in the management and administration of contributions, but they extended also to grants. However, in both the grants and contributions components of the program, signing authorities were exercised in compliance with the requirements of the *Financial Administration Act.*

11.316 The program's objectives are broad and had not been defined in terms of outcomes and measurable results. Results at the project level were not being tracked. An evaluation framework was being developed, but an evaluation of the program has yet to be carried out. Overall, little information on performance was available to support accountability and managing for results.

Corrective action addresses deficiencies

11.317 We audited SDPP projects that had been completed by the end of December 1999. Therefore, we did not expect to see the effects of the corrective action the Department took under its Six-Point Action Plan and under other initiatives following its 1999 internal audit. However, our assessment is that the corrective action the Department has taken and plans to take addresses the deficiencies we found in our audit of SDPP projects. We report the results of our detailed examination of the Department's corrective action in Part I of this chapter.

Sectoral Partnerships Initiative

Program Description

11.318 The Sectoral Partnerships Initiative (about $30 million annually) is a program launched in 1993 to fundamentally change human resources practices in Canada. It would do that by building, through partnerships, the capacity of the private sector to address strategic, sector-wide issues of national human resource planning, sectoral adjustment and job skills development. The initiative consists of eight activity streams and one subprogram (see Exhibit 11.19) managed from HRDC headquarters.

11.319 The objectives of SPI are to develop permanent, industry-led partnerships that co-ordinate human resource management in major industrial sectors, improve the relevance of the learning system, foster a learning culture, support interprovincial mobility, and contribute to labour market information. Since 1986, the government has provided over $200 million to support sectoral partnerships in some 40 industrial sectors.

Program Design

11.320 SPI has used two sources of funding for projects. Agreements signed before 1996 were negotiated under terms and conditions approved by the Treasury Board for the Canada Jobs Strategy (CJS) and funded from annual appropriations. In 1996, Parliament passed the *Employment Insurance Act*, enabling the Minister of HRD to use the Employment Insurance (EI) Account for projects benefiting insured participants. As of July 1996, SPI has used authority under terms and conditions approved by the Treasury Board for the Labour Market Partnerships component of Employment Benefits and

The Sectoral Partnerships Initiative (SPI) builds, through partnerships, the capacity of the private sector to address strategic, sector-wide human resource issues.

Exhibit 11.19

Sectoral Partnerships Initiative – Streams of Activity

- **Sector Study Agreements** – fact-finding and diagnosis of sector human resource issues, funded by HRDC and directed by an industry-led steering committee. Through Sector Study Agreements, partner relationships between key sector stakeholders, including HRDC, are formed. The resulting sector studies form the basis for subsequent human resource work by the sector partnership.
- **Sector Council Agreements** – start-up and core funding for Sector Councils to implement sector human resource solutions.
- **Occupational/Skills Agreements** – developing national occupational and skills standards.
- **Skills Upgrading Agreements** – developing skills upgrading and national certification on behalf of the sector.
- **Labour Mobility Partnership Agreements** – supporting interprovincial mobility in provincially regulated occupations.
- **Nationally Managed Programs Agreements** – agreements for national industries, inherited by Sectoral Partnership Initiative. Used to support experimental activities by sector groups, or infrastructure and activities of non-sector organizations.
- **Delivery Assistance Agreements** – improving the delivery of components of the Canada Jobs Strategy.
- **Rural and Remote Agreements** – assisting research and convening seminars on behalf of the agricultural community and rural and remote areas.

Subprogram:

- **National Sectoral Adjustment Service Agreements (NSAS)** – carrying out activities prior to or as part of a sector study or prior to the creation of a sector council, or initiatives identified by a sector council that fall within the Sectoral Partnership Initiative's mandate but not under the other business lines of the Human Resource Partnerships Branch.

Source: Departmental records

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Source: Departmental records

Support Measures (EBSM) to fund projects from the EI Account. Since November 1997, SPI has also had authority under the Human Resources Partnership Initiative to use annually voted appropriations to fund projects that benefit persons not insured under EI, but this authority has never been used.

11.321 Since July 1996, most SPI projects have been funded from the EI Account. However, HRDC has also continued to use Canada Jobs Strategy authorities since 30 June 1996 to fund new projects from annual appropriations (29 percent of our audit sample).

11.322 Under the Canada Jobs Strategy, sole authority to approve Sector Study, Sector Council, Occupational/Skills, Skills Upgrading and Nationally Managed projects lay with the Minister. Authority to approve Delivery Assistance, Rural and Remote, and Industrial Adjustment Service projects (renamed National Sectoral Adjustment Service or NSAS) was delegated by the Minister to senior departmental officials.

There are three fundamental eligibility criteria for all SPI projects: the organization must be national in scope, it must involve a partnership of all key sector stakeholders, and it must address a labour market issue.

Some activity streams have clear objectives and criteria but others do not

11.323 There are three fundamental eligibility criteria for all SPI projects: the organization must be national in scope, it must involve a partnership of all key sector stakeholders (business, employees, subsectors, regions), and the project must address a labour market issue. SPI assistance to a national sector usually begins with a sector study to define sectoral human resources problems while enabling HRDC to build a partnership with key sector participants. Often, this leads to stakeholders developing a consensus on solutions and priorities, identifying further development work in collaboration with HRDC, and creating permanent sector councils to take responsibility for human resource issues in their sectors. HRDC funds these partnerships until they become financially self-sufficient. Subsequent development work for the sector may result in Occupational/Skills and Skills Upgrading Agreements with councils or other sector groups. SPI supports interprovincial mobility in provincially regulated professions, through Labour Mobility Partnership Agreements negotiated with sector consortia. The objectives and core eligibility criteria specific to these five activity streams are clear.

11.324 Nationally Managed Projects Agreements have no specific eligibility criteria beyond the three fundamental criteria for all SPI activities; nor do they have stated objectives. Agreements under the National Sectoral Adjustment Service (NSAS) subprogram made up 51 percent of our audit sample. The objectives of NSAS are not clear, and its eligibility criteria are fairly open-ended.

Project Selection and Approval

11.325 Section 58 of the *Employment Insurance Act* specifies that partnership arrangements are to be developed and used for the conduct of project work. For SPI, the Department has translated this requirement into the sector council concept. A committee of sector stakeholders oversees the sector studies that define the nature of the government's involvement in the sector. Program managers advised us that sector studies inspire subsequent projects with partners and form the basis for assessing them, and that these studies also form the basis for the SPI annual work plans for each sector.

11.326 Our audit focussed on individual project files and their administration. We did not assess the validity of the sector studies themselves. Even allowing for the use of sector studies to guide other project work, we found weaknesses in the project selection and approvals process.

Project proposals not well documented

11.327 In 42 percent of the projects we audited, there was no identifiable proposal on the project file. This was true for both lower-value and higher-value projects. Project officers advised that in some cases proposals would not be identified as such because they were submitted in the form of draft agreements. When proposals are in this format, it is difficult to tell who originated them.

11.328 Of the files that contained identifiable proposals, few had adequate supporting documentation and analysis; 86 percent were missing the required cash flow forecast; and 43 percent had no timelines. Other gaps included information missing on objectives, budgets and work plans.

Missing or inadequate assessments

11.329 SPI management advised that before March 1998, project officers negotiated agreements with sponsors and brought SPI proposals to the Agreement Review Committee (ARC) for Branch review. SPI management found this process unsatisfactory because sponsors and project officers became overly committed to proposals — given their heavy investment of time during the project development phase — and directors then found it difficult to turn down projects.

11.330 In March 1998, SPI established a new project review process whereby project officers submit proposals along with their own assessment (usually in the form of a concept paper) for vetting by an extended management team. These teams, which include other project officers and directors, may recommend that the sponsor develop the proposal further or that it be approved.

11.331 We found that a little over 60 percent of the project files contained documented assessments. Among the files that did contain documentation, none had a timely risk analysis or a mandatory environmental impact prescreening. Although many sponsors had multiple agreements with SPI, we found that sponsors had not been checked for outstanding debt to HRDC.

11.332 Among the projects that we audited, only one assessment referred explicitly to the project's having been identified in a previous sector study.

In 42 percent of the SPI projects we audited, there was no identifiable proposal on the project file.

Loose application of eligibility criteria

11.333 Applying the core activity stream criteria to the projects we reviewed, we found that core eligibility criteria had been applied only loosely; few projects clearly met all the core eligibility criteria of the specific activity stream selected to fund them. We found that 16 percent of the projects in our sample (totalling $662,000) were not eligible for funding under the criteria of the particular SPI activity stream selected for each.

11.334 Activity streams selected to fund projects were often interchangeable; some projects could have been funded under a number of different activity streams. In some cases, when one agreement ended, the project activity would continue to be funded under a different SPI activity stream or subprogram.

We found that core eligibility criteria had been applied only loosely.

Some approvals not authorized; some not documented

11.335 SPI management advised that until 1998, the Agreement Review Committee assessed proposals and approved projects where authorized, or recommended their approval by the Minister. As of 1998, the extended management team recommends a project's approval to a directors' meeting. Directors then approve the project (where authorized), reject it, or recommend its approval to an assistant deputy minister, the Deputy Minister or the Minister as appropriate, according to the Minister's delegation of program authority.

11.336 It was not apparent from the documentation on file that the process operated as described. Of the projects requiring the Minister's approval, only 40 percent had clearly obtained it.

Another 40 percent either had been approved by unauthorized officials or had no record of who actually approved the project. For the remaining 20 percent, officials believed they had continuing authority from the Minister when agreements that had been funded under annual appropriations were converted to new agreements funded from the EI Account.

Of the SPI projects that did not require the Minister's approval, the actual approval of only one in five was documented.

11.337 Of the projects that did not require the Minister's approval, the actual approval of only one in five was documented. SPI management advised that the Agreement Review Committee had documented its decisions but a computer crash in 1998 wiped out those records. The directors' committee that replaced the Agreement Review Committee did not document decisions until very recently.

Thirty-eight percent of amendments were made inappropriately to extend the funding period after the agreement had already ended.

Financial Management and Control

Agreements often missing key information

11.338 Written contribution agreements were in place for all projects. SPI used standard formats that complied with Treasury Board guidance on specifying clear roles and responsibilities, terms of payment, eligible expenses and other relevant matters.

11.339 We found that only 41 percent of agreements were fully adequate. Fifty-four percent were missing key information (for example, funding periods, treatment of interest, mandatory separate bank accounts, and adherence to rules on conflict of interest) or included contradictory information. Authorized officials had signed 95 percent of the agreements.

Amendments were rarely made properly

11.340 When an agreement is amended, it is essential that both parties understand and agree on roles and responsibilities under the new conditions. In two thirds of amended agreements, the reasons for the amendments were not stated clearly. Furthermore, we were rarely able to identify who had actually been responsible for approving the amendments.

11.341 Most amendments consisted only of a new financial commitment form signed by a director or, occasionally, by unauthorized project officers. Only 20 percent of amended agreements contained proper articles of amendment signed by both parties and indicating their mutual agreement. Thirty-eight percent of amendments were made inappropriately to extend the funding period after the agreement had already ended.

Advances not always handled appropriately

11.342 In 78 percent of projects where advances were made, not all advances were based on projected or revised cash flows provided by sponsors. Most commonly, initial advances were based on cash flow estimates developed by HRDC officers for financial commitment forms.

11.343 In only 33 percent of cases did the payment of advances clearly follow Treasury Board rules on amounts that could be advanced. Of those projects that received multi-year funding, only a third clearly met Treasury Board rules on providing advances into a new fiscal year. We found in all but one case that advances were cleared by claims before further advances were issued. All requisitions for advances were certified by authorized officials under section 34 of the *Financial Administration Act*.

Failure to comply with terms of contribution agreements

11.344 SPI officers did not always hold sponsors to the terms and conditions of their contribution agreements or of the activity streams under which the projects were funded.

11.345 Separate bank accounts. SPI managers advised that they frequently waived specific contractual obligations to maintain a separate bank account for each project. Such accounts facilitate the tracking of expenses and revenues and, more important, they allow for the tracking of bank interest paid on federal funds held by sponsors and preclude the claiming of the same expenses under other agreements. In our audit, we were unable to determine the proportion of projects that had maintained separate bank accounts.

11.346 Eighty-seven percent of SPI agreements specified that interest earned by sponsors on funds advanced by the government had to be accounted for as part of the HRDC contribution. In 69 percent of the projects where this was required, it was not clear that interest had been handled appropriately — especially when sponsors had declared no bank interest. Our interviews with project officers provided no assurance that, where appropriate, sponsors were accounting for the interest earned on federal funds in their care.

11.347 Cost-sharing capital purchases. The terms and conditions of the umbrella Employment Benefits and Support Measures program under which most SPI agreements are negotiated require sponsors to cost-share any capital purchased. We found no cases that met this requirement. In the EBSM-funded portion of the dormant SPI projects we sampled, we found the value of capital purchased exclusively with federal money to be $250,000.

11.348 Eligible costs. Among other things, Schedule B of contribution agreements specifies eligible costs and the dollar amounts to be allocated to each eligible expenditure category. Reallocation among major cost categories requires HRDC approval. We found that agreements were rarely amended to authorize sponsors to exceed the agreed cost categories. As a result, 69 percent of the projects had overages in cost categories. In the remaining 31 percent it was not possible to tell whether there were overages, usually because the categories specified in Schedule B did not match the categories on the claim forms that sponsors used.

We found no cases that met the requirement for sponsors to cost-share any capital purchased.

11.349 Detailed expense claim information on file was very limited, especially for older projects whose sponsors had been required to submit only the most rudimentary supporting documentation — often containing only summary figures by approved cost category. On the basis of the limited supporting information available, we found that for the 49 dormant SPI projects we sampled:

- HRDC paid at least $284,000 for costs incurred before or after the funding period covered by agreements (see Exhibit 11.20);

Exhibit 11.20

Payments for Expenses Incurred Outside the Funding Period

- **The WITT National Network received $100,000 under an National Sectoral Adjustment Service agreement to evaluate its Construction Technology for Women program. A letter from the sponsor indicates that $52,000 worth of the work had already been completed before the agreement funding period started in April 1998. In our view, the claim for that part of the work should have been ineligible.**
- **The Canadian Tourism Human Resource Council (CTHRC) received an advance of $35,438 under a Delivery Assistance agreement. Four months after the agreement ended in March 1998, the sponsor submitted its total claim for $8,523. In a subsequent note to file, the project officer allowed the sponsor to claim an additional $16,823 for expenses incurred before the agreement. After adjustments, the CTHRC reimbursed the Receiver General $8,879.**

Source: Analysis based on departmental records

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- expenses amounting to $463,000 had been allowed through amendments made inappropriately after agreements had ended;

- HRDC paid $59,000 for costs in categories not covered by the agreements — such as administration costs that the agreement required the sponsor to pay, equipment rentals, ineligible overhead expenses and profits; and

- HRDC paid $179,000 for ineligible expenses in approved cost categories.

(The treatment of these kinds of administrative practices is discussed in paragraphs 11.77 to 11.80.)

11.350 In 92 percent of projects at least some expense claims were certified under section 34 of the *Financial Administration Act* by officers who did not have the necessary authority.

11.351 Reimbursement of GST. HRDC does not reimburse sponsors for GST that they can recover from the Canada Customs and Revenue Agency (usually 50 percent of GST paid). Sponsors are required to account for the amount of GST they can get back. In 56 percent of projects, it was not clear that GST had been treated appropriately. In many claims, the sponsor did not state the total amount of GST that had been paid. We found other claims that charged HRDC the full amount of GST paid. There are items on which a sponsor might not pay GST (for example, on wages) or an unincorporated group might not be able to get a GST refund. However, few project officers we interviewed could assure us that sponsors had properly accounted for reimbursable GST.

In 29 percent of all SPI projects there was no on-site financial monitoring visit by project officers.

11.352 Cost-sharing of projects. A significant feature of sector participation in SPI is that partners share in project costs. Partner cost-sharing contributions can be in kind (for example, partners' time or facilities) or in cash (directly paid to cover eligible expenses). The agreements specify a maximum dollar amount that HRDC will contribute. Most also specify a maximum percentage of total project costs as the federal share and stipulate that the federal contribution will be the lesser of the percentage share and the maximum dollar amount. For clarity, many agreements also specify the otherwise implicit minimum contribution of partners, in dollar amounts and in percentage share.

11.353 We found that in 29 percent of projects, partners failed to deliver the minimum contribution they had agreed to. In the 49 sampled projects, HRDC had paid $889,000 more than the maximum specified without formally amending the agreements. SPI management asserts that the requirement for minimum contributions by partners is not meant to be enforced and is only leverage to ensure their participation.

Inadequate financial monitoring

11.354 The SPI Program Guidelines (1994) state that an initial monitoring visit should take place within four weeks of the start of a project. Interim visits should take place as necessary, depending on the project's complexity and size, sponsor experience, and political volatility. A final visit must be made at the end of the project and before final payment is requisitioned. We expected to see a monitoring effort commensurate with the assessed risk of individual projects.

11.355 We found that there was no monitoring plan for 96 percent of projects, nor were the projects monitored in a timely manner, consistent with their risk. Although desk monitoring of claims is useful, it is primarily through on-site financial monitoring visits that officers are able to examine detailed receipts and truly verify claims. In 29 percent of all projects (45 percent of projects under $150,000) there was no on-site financial monitoring visit by project officers. Of projects where financial monitoring visits were made, 59 percent had only one visit, after the end of the agreement and after the final payment had been requisitioned. Exhibit 11.21 shows the on-site monitoring done for the three highest-value projects in our sample.

11.356 Program managers told us that in light of the ongoing relationship between project officers and sponsors, SPI relied heavily upon desk reviews of individual claims (often supported by a copy of the sponsor's general ledger) as an alternative to on-site financial monitoring visits during the project. Given the nature and extent of the financial management problems we identified in our audit, we believe that desk monitoring of claims coupled with a single financial monitoring visit after the project has ended and all payments have been requisitioned is insufficient to ensure that moneys are used for intended purposes.

11.357 The Department's monitoring discovered some inappropriate payments and some were corrected. However, in many cases the sponsor would merely be warned against claiming ineligible expenses in future projects or advised to reimburse HRDC through another agreement. In our view, this practice is not appropriate. Files on 67 percent of the projects that required a minimum contribution from the sector contained no detailed documentation or verification of the in-kind and in-cash claims made by the sponsor. None of the projects were closed properly (that is, advances reconciled with claims, claims and revenues verified, ineligible expenses identified, overpayments recovered, all reports completed), and only 18 percent had any activity monitoring reports on file.

Project Results

Project results not documented

11.358 The agreements we audited did specify planned outputs. However, we found that information on results was inadequate in 91 percent of the projects. In 68 percent, we found no indication that the required outputs had been delivered; in 85 percent, sponsors failed to provide the mandatory final project report.

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11.359 We found on file very few final assessment reports written before the events of January 2000, when management tightened reporting requirements. There was little evidence on file that SPI management knew what results project sponsors were achieving.

Effectiveness Measurement and Reporting

The Department has taken some action in response to a 1997 evaluation

11.360 An evaluation report on the SPI was published in November 1997. The

Exhibit 11.21

On-Site Financial Monitoring – Three Highest-Value Projects

- The Canadian Steel Trade and Employment Congress received $6.5 million for a three-year project. It had only one on-site financial monitoring visit – three months after the end of the project. Of the information provided by the sponsor, the program officers looked at 10 receipts totalling $33,000 and found no problems.
- The Canadian Steel Trade and Employment Congress received another $5.95 million for a three-year Skills Upgrading project. It received only one on-site financial monitoring visit – nine months after the project had ended. Of the information provided by the sponsor, program officers looked at 11 receipts totalling $485,700 and were provided with information on in-kind contributions.
- The Canadian Tourism Human Resource Council received $2.76 million for a three-year Occupational/Skills project. It had only one on-site financial monitoring visit - two months after the project had ended. We found that HRDC did not challenge three non-compliant, untendered contracts over $25,000 or challenge $119,586 in capital expenses that were not cost-shared as required. Nor did it verify that the sector had made the required sector contribution.

Source: Analysis based on departmental records

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Source: Analysis based on departmental records

evaluation methodology involved interviews, a search of the literature, case studies and surveys. In our view, the methodology was appropriate to the nature of the program results examined by the evaluation.

11.361 The evaluation found that programs sponsored by sector councils were bringing about systemic change — developing a training culture, increasing employers' interest in training and standards, increasing skill levels in the workforce, and facilitating school-to-work transition. There was some evidence of limited improvements in productivity and profitability. The evaluation found that the approach resonated well with the general public, that employers and employees supported the sectoral partnership approach, and that the rationale for SPI had not diminished.

11.362 However, the evaluation also pointed out that SPI agreements contained few statements on intended impacts and effects, and there were few provisions in the agreements for ongoing data collection and evaluation. Indeed, the evaluation noted that sponsors did not see themselves as accountable for the intended impacts and effects of the SPI; there was a lack of sector support for accountability and a lack of relevant data on results. The evaluation called for stronger reporting requirements to help clarify commitments to results, and for strategies to measure the performance of sectors in contributing to SPI's objectives.

A 1997 evaluation showed that both awareness and the take-up of the SPI program were low, and the participating sector councils had made only slow progress toward self-sufficiency.

11.363 The evaluation stressed the need to communicate the activities and experiences of individual sector councils in order to avoid duplication and to strengthen the efforts of all sector councils. Marketing of sector council products and services was notably weak and too often not timely. The evaluation found that both awareness and the take-up of the program were still low, and the participating sector councils had made only slow progress toward self-sufficiency. The three-year time frame for achieving core operational self-sufficiency appeared to be unrealistic for most sectors.

11.364 SPI subsequently attempted to resolve the cross-sectoral communications issue, in part by further encouraging the work of the Alliance of Sector Councils. To address the self-sufficiency of sector councils, SPI restructured its funding model by eliminating the formula of declining funding (thereby providing full funding in the start-up and early operational phases), by providing core funding for a longer period (up to five years instead of three years), and by requiring councils to build reserve funds that would eventually be the basis for their financial independence. SPI also made provision in subsequent agreements for the marketing of sector council products. Responses to the evaluation recommendations on results measurement and the accountability of sponsors are still at the planning stage.

Concluding Comments

11.365 We concluded that there were serious deficiencies in the management control framework of the Sectoral Partnerships Initiative program. We also found lack of compliance with the legal requirements of section 34 (certifying expense claims) of the *Financial Administration Act* and with the Treasury Board's policy on the treatment of advance payments.

11.366 The Department's evaluation of SPI found progress in the development of partnerships but significant weaknesses in sponsors' provision of information that is needed to measure project results. Our audit supports this evaluation finding. Although SPI has been planning improvements in collecting information on results from sponsors, these improvements have yet to be implemented in agreements.

Corrective action to address deficiencies

11.367 We audited SPI projects that closed by the end of December 1999. Therefore, we did not expect to see in those projects the effects of the corrective action that the Department took under its Six-Point Action Plan and under other initiatives following its 1999 internal audit. However, our assessment is that the corrective action the Department has taken and plans to take addresses the deficiencies we found in our audit of SPI projects. We report the results of our examination of the Department's corrective action in Part I of this chapter.

11.368 SPI management states that in managing the program it must balance three factors: developing and sustaining partnerships, ensuring quality products and projects, and controlling costs. However, we believe that SPI management must also address the continuing challenge of achieving and maintaining an appropriate balance between creating, advocating and sustaining partnerships in this program and meeting the responsibility for prudent management of public funds. The findings of our audit show that this latter balance had not been achieved in the period to December 1999.

Conclusion

11.369 Human Resources Development Canada operates under direction from Parliament through its Minister, from Cabinet and Cabinet committees such as the Treasury Board, and from a number of other centres in government, and guidance from the Clerk of the Privy Council as the Head of the Public Service. Decisions to downsize, reduce budgets and restructure HRDC were made outside the Department. Directions to carry out specific programs and policies come from Parliament and Cabinet. Directions for financial administration come from Parliament and more specific directions from the Treasury Board. The factors that contributed to problems in the management of grant and contribution programs were not solely within the Department's purview.

11.370 In the 1990s central direction, encouraging managers to innovate and improve service by reducing red tape, often resulted in conflicting messages to public service managers. In their reports to the Prime Minister, Clerks of the Privy Council spoke frequently of improving service, improving communication and improving staff morale — but rarely of financial management. The Treasury Board Secretariat moved away from detailed policies, relying less on pre-transaction approvals and more on general policies and guidelines and the sharing of best practices. The Secretariat received less detailed information on the activities of departments.

11.371 Initiatives within HRDC to emphasize service delivery, empower local employees, and reduce the plethora of manuals providing direction to staff were consistent with messages and actions of the Clerk and the Secretary to the Treasury Board. Neither advocated a lack of care and responsibility in spending public funds. Yet these fundamentals of public administration did not get sufficient attention. With its reduced monitoring role, the Treasury Board Secretariat was not immediately aware of the problems at HRDC in managing grants and contributions.

11.372 Over the decade of the 1990s, HRDC's capacity to manage grant and contribution programs properly declined. It lost experienced staff; guidance was not up to date; staff were not properly trained and supported; and key controls and accountability structures were weakened. Current management recognizes these weaknesses and is taking a number of actions to correct them.

11.373 Our audit of four programs confirmed and extended the findings of HRDC's 1999 internal audit. We concluded that in the period up to December 1999 there were serious deficiencies in the management control framework of each of the four programs audited. In particular, there were weaknesses in key aspects of project selection and approval processes and in the financial management and control of projects, including lack of compliance with Treasury Board policy and the requirements of the *Financial Administration Act.* In all of the programs, poor administrative practices resulted in inappropriate handling of project payments and advances, and in insufficient attention to project monitoring.

11.374 We found that we could rely on the 1999 internal audit to describe the systemic weaknesses in HRDC's management of grants and contributions. The internal audit was not designed to generalize its findings to program expenditures or to the management of specific programs.

11.375 Earlier in the 1990s, internal audit had twice advised management that there were serious weaknesses in the Department's approach to managing grants and contributions. But senior management did not take corrective action. This lack of management attention to reports of control weakness resulted in a more severe and widespread problem later.

11.376 Internal audit is a valuable tool for management to identify weaknesses in control systems and provide a guide to appropriate action. It is a function that management needs to protect and support. Internal audit needs to be able to work independently and to a high professional standard. And management needs to pay close attention to the findings of internal audit.

11.377 Management of HRDC is making good progress in meeting the commitments made in the Six-Point Action Plan and other plans formulated to correct identified problems. The Department is implementing the plan for staffing and equipping staff. It has developed new organizational models for project management at the field level and is currently working on filling the new positions. However, as management recognizes, effort will have to be ongoing and sustained, with careful monitoring, to effect long-lasting improvement. An innovative performance tracking system has been implemented to monitor performance and progress.

11.378 Managing grants and contributions for results needs to improve. None of the programs we audited had consistently measured project results. In TJF/CJF and YIC, project results were defined in measurable terms, but there was a lack of follow-through in their measurement and reporting. In the other two programs the objectives are broad, and have not been defined in terms of outcomes and measurable results. Although the SPI has plans to improve the collection of information on results from sponsors, these improvements have yet to be implemented.

11.379 The information that is available needs to be better used to make adjustments and improvements in program delivery and design. Program evaluations had been completed for three of the four programs we audited, although the evaluation of the TJF was preliminary and a planned further evaluation of TJF and CJF did not proceed. An evaluation framework for the SDPP is being developed, but an evaluation has yet to be carried out. The findings of the TJF and SPI evaluations were used to make some program changes. Evaluations of these programs need to examine the difficult questions of program rationale and effectiveness in order to properly inform the public debate about the value of the programs.

11.380 The Standing Committee on Human Resources Development and the Status of Persons with Disabilities asked that we address how to balance the need for efficient and flexible program delivery with the need for sound financial management. As part of the Action Plan, the Department itself is addressing this issue.

11.381 A fundamental part of dealing with the often-conflicting demands placed on public servants is ensuring that the capacity needed to deliver the programs is in place. The Department recognizes that the capacity to deliver its grant and contribution programs was not in place. It has defined a number of actions to improve its capacity. Questions remain about the appropriate level of staffing needed to deliver grants and contributions.

11.382 It is important that HRDC collaborate with the Treasury Board Secretariat to carry out workload studies and establish benchmarks for the delivery of these types of programs.

11.383 Managers and project officers need to be given flexibility to carry out their duties. But with discretion comes the need for clearly defined expectations, so there is a common understanding of what is to be delivered, and how. Increased discretion brings the requirement of strong accountability for the discretion exercised and the results achieved.

11.384 The most difficult part of balancing efficiency, flexibility and control is the judgment that public servants are asked to exercise. Not all grant and contribution programs are of equal risk, nor are all projects in a program. Judgment is needed to assess risk and determine how it should be managed. For grant and contribution programs, we expect the key controls to be in place for all projects. Yet some proposals can be assessed in a few minutes while others can take many days. In either case, public servants are responsible for the decisions they make, and those decisions should be part of the record of a project. Documenting smaller, low-risk projects would take little time; for larger projects it would involve much more. In March 2000 we published a *Risk Assessment Framework for Grant and Contribution Programs* to provide managers and staff with a tool for assessing and managing risk, and to provide parliamentarians with an approach to reviewing the performance of these programs.

11.385 There is no simple answer to what the ideal balance should be. As the results of our audit show, it is essential that key controls be in place and minimum standards observed. That these controls are a requirement needs to be spelled out clearly and understood by staff. Then public servants have the foundation to innovate in the delivery of programs and to strike the most appropriate balance between efficiency and flexibility in program delivery and sound financial management.

Department's summary comment: *HRDC takes seriously all the issues raised in the Auditor General's report and in the 1999 internal audit of grant and contribution programs. The Department is determined to build on the improvements it has already made. HRDC will fulfil its Action Plan. It will complete the other supporting initiatives undertaken following the launch of the Plan. Furthermore, HRDC is undertaking additional steps to strengthen these actions in response to this report. HRDC will continue to work with all interested parties to ensure that it achieves the right balance between responsive client service and prudent management of taxpayers' money.*

The Department's responses to specific recommendations and its overall comment are included in Part I of the chapter, following paragraph 11.149.

About the Audit

Objectives

Our objectives were to determine the following:

- the extent to which reliance can be placed on the results of HRDC's 1999 internal audit and its performance tracking system;
- the Department's progress in implementing its corrective action plan;
- the adequacy of the Department's management control framework for the grant and contribution programs we selected for audit;
- how HRDC has measured and reported the results achieved by the selected grant and contribution programs; and
- the Department's compliance with financial authorities such as the *Financial Administration Act* and Treasury Board policies.

Scope and Approach

Our audit focussed on the management of grant and contribution programs in HRDC. We carried out a detailed audit of four programs: the Transitional Jobs Fund (TJF) and its successor program, the Canada Jobs Fund (CJF); Youth Internship Canada (YIC); the Social Development Partnerships Program (SDPP); and the Sectoral Partnerships Initiative (SPI). In addition to examining the management of individual projects under each program, we assessed the design of the programs and the measurement of project and program results.

We selected projects that, with few exceptions, were completed on or before 31 December 1999. This allowed us to audit the full project life-cycle and to make an independent assessment of the nature and extent of problems that the Department's corrective action, taken in response to its 1999 internal audit, needed to address. We selected all of the high-value projects and stratified random samples from the remaining projects in the populations we audited. Our results are accurate within plus or minus 10 percent, 19 times out of 20.

In all four programs, we reviewed the project files in light of our audit criteria. We supplemented our file reviews and confirmed our findings on each file by interviewing project officers and others involved in managing the projects. The TJF/CJF and YIC programs involved projects managed by Human Resource Centres of Canada (HRCCs) across the country. We visited most of the HRCCs responsible for the projects in our samples. For the locations that we could not visit cost-effectively, we asked that the project files be forwarded to the nearest HRCC that we would be visiting, or to Ottawa. We also visited six regional offices in eastern Canada and requested information from British Columbia.

We assessed the corrective action taken by the Department in response to its 1999 internal audit in order to determine whether that action would adequately address our audit findings in each program. We reviewed the Department's progress in implementing its Six-Point Action Plan and other initiatives that form an integral part of its corrective action.

In assessing the corrective action the Department has taken or plans to take, we reviewed HRDC documents, interviewed officials, and examined the methods the Department is using to track and report its performance in improving the management of grant and contribution programs.

Finally, we interviewed a number of former and current senior managers in the Department to obtain their views on the underlying reasons for the problems at HRDC. We also reviewed previous internal audit reports, documents on various management initiatives and minutes of key departmental committees.

Criteria

Our audit was based on the following criteria:

- The objectives of grant and contribution programs should be clearly stated. Appropriate program eligibility criteria should be established that are consistent with the program objectives, the Department's legislative mandate and the requirements of central agencies.
- Appropriate procedures should be established to ensure that projects selected for funding are those most likely to contribute to achieving program objectives. These procedures should be documented and followed.
- Roles and responsibilities should be clearly defined and transparent.
- The Department should have in place the capacity to implement the programs.
- The Department should appropriately monitor approved grants and contributions and report the results. As part of this, overpayments and repayments should be identified on a timely basis.
- Financial and management control of program expenditures should comply with relevant government policies and legislation.
- A program accountability framework, including performance measurement and reporting, should be developed and clearly communicated. It should include assignment of responsibility for achieving results and complying with program requirements.
- The Department should measure, monitor and report to Parliament on performance. Program evaluation activities should be closely co-ordinated with internal audits.
- The designation of transfer programs as grants should be reserved for those situations where it is demonstrably appropriate for transfers to be unconditional.

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Report of the
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to the House of Commons

Chapter 12
Values and Ethics in the Federal Public Sector

October 2000

This October 2000 Report comprises 8 chapters as well as a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Values and Ethics in the Federal Public Sector

Main Points

12.1 Canadians expect that the federal public sector will be a world leader in promoting sound values and ethics in government. Ensuring sound values and ethics is a vital part of good governance that supports and respects fundamental democratic values.

12.2 A comprehensive and sustained dialogue with Canadians and throughout the federal public sector is required. We propose a framework for action that includes eight priorities. We suggest that action start with the following two priorities.

- Reinforce leadership for promoting ethical conduct by, for example,
  - clarifying the principle of ministerial responsibility and the responsibilities of officials; and
  - identifying the responsibilities of senior and line managers for promoting sound values and ethics.
- Re-invigorate an extensive dialogue on values and ethics that emphasizes the primacy of the principles of respect for the law, the public interest, and public service as a public trust.

12.3 Sound values and ethics are needed to maintain probity. There is a strong foundation of values and ethics in the federal public sector. This foundation should not be taken for granted. The government is taking steps to maintain sound values and ethics. Most of these measures are limited or in their preliminary stages. To increase the likelihood of success, values and ethics initiatives have to be carefully developed, implemented, and monitored by using the best available practices. A prerequisite for success is the leadership of parliamentarians, ministers and senior officials.

12.4 The federal government needs to develop an implementation plan with deadlines to address values and ethics priorities across the public sector and in federal entities. We will continue to monitor and report to Parliament on values and ethics initiatives in the public sector.

Background and other observations

12.5 We focussed on values and ethics initiatives that promote ethical decision making that is in the public interest. These initiatives would form part of a comprehensive approach to good governance in federal entities.

12.6 In May 1995 we reported to Parliament on ethics and fraud awareness in government. In 1996 the government completed A Strong Foundation: Report of the Task Force on Public Service Values and Ethics (Tait Report). These reports contributed to forging a consensus on the values and ethics issues that need to be addressed in the federal public service.

12.7 Ensuring ethical decision making is the responsibility of all members of the federal public sector and private sector companies as well as organizations and individuals who receive funds from or do business with the public sector.

12.8 Major changes are occurring in the way government organizes and delivers its programs. These changes include deregulation, downsizing, increasing delegation of decision making to officials in the field, contracting out and entering into partnerships with the private sector. As well, the government is using new technologies, and its work force is becoming more mobile and diverse. As a result, the government is increasingly relying on a strong foundation of values and ethics to make decisions in the public interest.

12.9 As part of good governance efforts, several departments are implementing major values and ethics initiatives. Others do not assign a high priority to developing comprehensive values and ethics initiatives. We believe that all entities should objectively assess and report on values and ethics.

The responses of the Privy Council Office, the deputy minister co-champions for values and ethics in the public service, the Secretary of the Treasury Board and the Ethics Counsellor are included at the end of this chapter. They agree with our assessment of the initiatives under way and acknowledge that there is an important need for further work.

Introduction

12.10 Probity (or honesty) in government is a traditional concern of auditors general in parliamentary democracies. It is maintained through cost-effective financial and management controls and approaches based on sound values and ethics. This study focusses on values and ethics approaches. Other chapters in this Report look at financial and management controls.

12.11 Sound values and ethics are needed to maintain probity. The federal government is taking steps to maintain sound values and ethics in the public sector. To increase the likelihood of success, values and ethics initiatives have to be carefully developed, implemented, and monitored by using the best available practices.

12.12 There is a growing body of experience on how best to promote values and ethics in government. For example, major companies and certain government departments have initiated significant ethics programs. These programs recognize that it is unrealistic to expect that, by themselves, values and ethics initiatives will ensure probity. A considered balance of reliance on financial and management controls and on values and ethics approaches is required. Exhibit 12.1 illustrates the main elements of these controls and approaches.

12.13 Over time, changes in government have made it clear that ensuring probity will increasingly rest on a strong foundation of values and ethics. The 1984 report by Michael Starr and Mitchell Sharp, Ethical Conduct in the Public Sector (Starr-Sharp Report), was one of the first major studies of values and ethics in Canada.

12.14 The increased emphasis on values and ethics reflects changes in government structure and approach — in particular, the focus on deregulation and the reduction of management supervision and the corresponding emphasis on the empowerment of employees, changes in public service values, the growing number of alternative service delivery agencies, the increasing partnerships with the private sector, the privatization of certain government services, and greater public scrutiny of government programs. The situation will become more complex in the near future as new employees from diverse backgrounds are hired to replace many retiring public servants, as employees enter and leave the public service more frequently, and as government organizations adopt new technologies.

Ensuring probity will increasingly rest on a strong foundation of values and ethics.

Exhibit 12.1

Elements of Controls and Values and Ethics Approaches to Maintain Probity in Government

Financial and management controls

- Control frameworks for
  - risk management
  - financial management
  - physical resource management
  - human resource management
- Information to
  - manage operations
  - support decision making
  - demonstrate accountability

Source: Office of the Auditor General, Financial Management Capability Model, 1999

Values and ethics approaches

- Political and senior management leadership that promotes ethical conduct
- Clear statements of values and ethics or codes of conduct
- Approaches to decision making that
  - require consideration of values and ethics
  - align management policies to support ethical conduct
  - offer recourses to report ethical concerns
- Clear guidance for interaction between the public and private sectors
- Assessment of and reporting on effectiveness of values and ethics initiatives

Source: Organization for Economic Co-operation and Development, Principles for Managing Ethics in the Public Service

12.15 Increasing discretion and the complexity of program objectives also mean that public servants are being asked more frequently to balance several justifiable or equally valued courses of action. In Chapter 1 of our May 1995 Report, we presented to Parliament a study, Ethics and Fraud Awareness in Government. We reported the results of a survey of a random sample of public servants on ethical issues. We suggested a framework for ethics in government, consisting of a statement of principles, leadership, empowerment of public servants, transparent decision making, ethics-related training, a mechanism for discussing and reporting ethical concerns, and a continuous process that makes ethics a conscious and visible part of day-to-day decision making (see Appendix A). Subsequent reports have recommended frameworks similar to our own.

Values and ethics initiatives are not sustainable without leadership at the highest levels and a commitment to act.

12.16 Since our Report, there have been significant values and ethics initiatives in the federal government. The first major event was the publication in December 1996 of A Strong Foundation: Report of the Task Force on Public Service Values and Ethics (Tait Report). As chair of the task force, John Tait, a distinguished senior public servant, emphasized the need for an ongoing robust dialogue on values and ethics — an encouraging development.

12.17 The Canadian Centre for Management Development (CCMD) reissued the Tait Report in January 2000 to help reinvigorate the dialogue. Since its publication, the report has become the key instrument for promoting values and ethics in the federal government. Mr. Tait supported our Office's undertaking a second study, and many of the conclusions of his report were the starting points for our study.

12.18 A second major event was when the Organization for Economic Co-operation and Development (OECD) published in April 1998 its set of Principles for managing ethics in the Public Service. Canada, along with the other member countries of the OECD, has subscribed to these principles. We interpret the phrase "managing ethics" to mean managing ethically by promoting respect for and discussion of values and ethics that are inherent in democratic institutions and society. Because the principles represent a wide consensus, we used them as benchmarks for our study.

12.19 The major works on values and ethics have a common theme: The promotion of values and ethics is an essential part of a good governance framework that needs to be continually and systematically addressed to help ensure probity and the long-term viability of federal entities.

Focus of the study

12.20 Our objective is to stimulate sustained and transparent discussion and action on values and ethics by Canadians and members of the federal public sector. In this study, we focus on values and ethics initiatives that promote ethical decision making as part of a comprehensive approach to good governance in federal entities. Our observations integrate the OECD principles, the recommendations of major federal public sector reports, and the better values and ethics practices in government and the private sector.

12.21 Values and ethics initiatives are not sustainable without leadership at the highest levels and a commitment to act. Thus, one of our primary concerns was the leadership responsibilities of parliamentarians, ministers, and heads and managers of federal entities.

12.22 Because most of the federal public sector initiatives were in their early stages of development, we did not conduct an in-depth assessment of their implementation or their effectiveness in changing attitudes and behaviour.

12.23 More details about our study's objective, scope, approach and criteria are at the end of this chapter.

Observations

Values and Ethics Assessments

The Tait Report

12.24 The Tait Report was a major step forward in forging a consensus on the values and ethics issues that need to be addressed in the federal public service. It is the most recent comprehensive assessment of the state of values and ethics in the public service. The report focussed on values and ethics that are fundamental to the sound functioning of the public service. It reaffirmed the primacy of law and the public interest as essential pillars of public administration. It proposed the adoption of an "ethics regime" similar to the framework we presented in our May 1995 Report.

12.25 The Tait Report recommended major initiatives to promote values and ethics (see Exhibit 12.2). Among its key recommendations were initiating a wide-ranging and honest dialogue on values and ethics within and outside the government, adopting a statement of principles for the public service, establishing recourse mechanisms for expressing ethical concerns, and developing comprehensive ethics regimes government-wide and in individual public service organizations.

12.26 The Treasury Board and The Leadership Network have recently assessed the work undertaken to address these recommendations. (The Leadership Network's role is to promote, develop and support networks of leaders in the public service.) The assessments indicate that most of the work is in its preliminary stages. In January 2000 the Treasury Board Secretariat informed deputy ministers that most public servants have not heard of the Tait Report and have not participated in or are not aware of discussions related to the report.

Most of the work to address the recommendations of the Tait Report is in its preliminary stages.

Exhibit 12.2

Major Values and Ethics Initiatives Recommended in the Tait Report

- Initiate a wide-ranging and honest dialogue on values and ethics.
- Re-focus the character of public service as a public trust.
- Adopt a statement of principles for the public service.
- Adopt comprehensive ethics regimes government-wide and in public service organizations.
- Clarify for both the political and public service levels the principles of responsible government, the concept of ministerial responsibility and the role the public service is expected to play.
- Acknowledge the confusion, tension and conflicts between "traditional" and "new" public service values, and establish an appropriate balance between these values, giving primacy to the public interest and respect for law.
- Reaffirm that speaking truth to power is a public service value.
- Establish suitable recourse mechanisms for public servants who may feel that they are under pressure or have been asked to perform actions that are unethical or contrary to public service values and to the public interest.
- Align systems, policies, and processes to ensure that they support a sound public service culture and values.
- Hold deputy ministers and managers accountable for leading by example and ensuring that core public service values are understood and respected.
- Establish an independent body for non-partisan appointments so that patronage appointments do not threaten the integrity of the public service.

Source: Tait Report

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Source: Tait Report

Furthermore, public servants continue to believe that senior managers do not lead by example.

12.27 In its spring 2000 review of the dialogue initiative, The Leadership Network reported that values and ethics are recognized as challenging subjects, but that departments may not have the capacity to lead and sustain the dialogue. As well, there is an absence of a formal accountability process and a lack of follow-up to gauge the success of values and ethics initiatives. The review also concluded that there is strong support in departments for the following:

- evaluating ethical performance as a basis for appointments and promotions;
- encouraging ethics education and training; and
- deliberately raising ethical considerations at meetings.

Consultations with middle managers

12.28 There are about 30,000 middle managers in the public service. From March to June 1998 the Learning Advisory Panel for Middle Managers consulted them on the major challenges and opportunities facing the public service. The panel's 1998 publication, The View From Here, contains the results of the consultations. On values and ethics, it reports that there is "continuing cynicism, embitterment and lack of trust." It recommends the following:

- a professional code of conduct for middle managers within an accountability framework;
- a regional ethics counsellor; and
- a clear and concise statement of federal public service values and ethics or code of conduct.

Treasury Board's survey of public servants

12.29 The Treasury Board's 1999 survey of public servants also indicates that there are vulnerabilities in the area of values and ethics. Exhibit 12.3 presents some results that are relevant to our study.

12.30 According to the results, most public servants are treated by their colleagues with respect, and the work units operate in an open and honest manner. However, we are concerned that a significant number of public servants strongly or mostly agree that they cannot explain to others the vision, values or mission of their department or agency, that they do not have a fair chance of getting promoted, that they cannot disagree with their immediate supervisor without reprisal or that senior management will not try to resolve concerns raised in the survey.

Assessment of comptrollership capacity

12.31 As part of a pilot program, the Treasury Board's April 2000 assessment of comptrollership capacity in five departments indicates that overall they had ethics statements and communicated written policies across their organizations. However, departments applied their policies inconsistently.

Most Initiatives Promoting Values and Ethics Are in Their Early Stages

12.32 Clearly, the ambitious initiatives recommended by the Tait Report have yet to be realized. As well, the most recent assessments of the values and ethics challenges in the public service show that there is much work to do. There also is significant concern for ensuring a strong foundation of values and ethics at the federal level. Measures have already been taken and, although they are in their preliminary stages of development and implementation, additional initiatives are under way. Moreover, key public service leaders such as the Clerk of the Privy Council and the deputy minister co-champions for values and ethics are aware of the need for action. They have initiated significant efforts to re-invigorate discussion and action across government.

12.33 Prior to our May 1995 Report, the federal government had taken several significant initiatives to promote sound values and ethics. Post-employment and conflict-of-interest guidelines for ministers and those appointed by the Governor in Council (GIC) had been put in place; similar guidelines had been established for public servants. The role of the Assistant Deputy Registrar General had been expanded into the position of Ethics Counsellor, who reports to the Prime Minister. The Ethics Counsellor provides advice to ministers and GIC appointees and receives disclosure-of-asset statements from them. He does not provide advice to staff in departments and agencies. The Ethics Counsellor is also responsible for a registry of lobbyists.

Exhibit 12.3

Results on Values and Ethics in the Treasury Board's 1999 Survey of Public Servants

(percentage)

Statement	Strongly agree	Mostly agree	Mostly disagree	Strongly disagree	Don't know/ Not applicable
I can clearly explain to others the direction (e.g., vision, values or mission) of my department/agency.	17	47	20	10	5
I feel I can disagree with my immediate supervisor on work-related issues without fear of reprisal.	26	48	12	8	5
In my work unit my colleagues treat me with respect.	42	52	4	1	1
In my work unit we operate in an open and honest way.	30	51	13	4	1
In my work unit every individual, regardless of his or her race, colour, gender or disability, would be/is accepted as an equal member of the team.	51	36	6	4	3
I believe I have a fair chance of getting a promotion given my skills and experience.	10	33	24	23	9
In my work unit the process of selecting a person for a position is done fairly.	17	43	18	12	9
I believe that senior management will try to resolve concerns raised in this survey.	7	30	28	23	11

Note: The Treasury Board states that due to rounding, percentages may not add to 100.

Source: Treasury Board Secretariat

12.34 Since our May 1995 Report, there have been further major values and ethics initiatives (see Appendix B).

Interdepartmental initiatives

12.35 The government has created independent panels and deputy minister committees to address wide-ranging concerns in specific functional areas and sectors: comptrollership across government and the effective use of science and technology in government. The Public Service Commission of Canada also leads a staffing reform initiative. The reports of the panels, the committees, and the Commission cover a broad range of issues. Most of the efforts to address the values and ethics issues raised in the reports are in their preliminary stages.

Since our May 1995 Report, there have been further major values and ethics initiatives.

12.36 **Comptrollership.** The Independent Review Panel on Modernization of Comptrollership in the Government of Canada presented a report in October 1997. It concluded that among the prerequisites for sound management was a common base of accepted, understood and practised values and ethics to guide and permit more independent decision making. Using the panel's criteria, the Treasury Board Secretariat asked five departments to initiate, as a pilot program, a self-assessment of capabilities, including the extent to which ethical practices and values are in place.

12.37 **Science and technology.** The public's confidence in government use of science and technology to protect the economy and health and safety of citizens has been shaken by recent crises, such as the diminishing Atlantic and Pacific fish stocks and the threatened safety of our blood supply.

12.38 In response, the federal government has sought to establish mechanisms to ensure that it considers sound scientific advice in forming policy and regulations. To achieve this end requires the resolution of conflicts between the values of the science and technology community, the policy formulation process and the responsibilities of the political level.

12.39 In 1996 the government published Science and Technology for the New Century: A Federal Strategy, in which it called for science-based departments and agencies to establish external advisory bodies. In March 1999 the major science departments issued a statement of best practices for the conduct and use of science and technology in government. The statement included scientific and public service values such as integrity, objectivity, transparency, professionalism, respect for people, excellence and accountability.

12.40 The government broadened the initiative to include consultation across the country. In May 1999 the Council of Science and Technology Advisors presented a report, Science Advice for Government Effectiveness. In June 2000 the government published A Framework for Science and Technology Advice. Among the key values that motivate the reports are the following:

- inclusiveness to ensure that advice is drawn from a variety of scientific sources and from experts in many disciplines; and
- openness to ensure that governments employ science in decision-making processes that are transparent and open to stakeholders.

12.41 **Values-Based Merit Framework.** In 1990 the federal government assessed public service staffing in Public Service 2000: Report of the Task Force on Staffing. The Public Service Commission looked at this issue in its 1996 Consultative Review of Staffing. These reports recommended that the staffing system focus more on judgment, values and ethics and less on prescriptive controls and rules. To implement this recommendation, the

Public Service Commission has launched a Staffing Reform initiative. According to the Commission, most staffing responsibilities have now been delegated to managers, and departments are expected to create customized approaches to staffing and accountability. The Commission told us that the potential results of delegation have not been fully realized because there has been no values-based framework to guide managers in the exercise of their new powers.

12.42 The Commission is implementing a Values-Based Merit Framework to support managers. The focus of the framework is the achievement of an ethical balance of key merit values and management principles. The Commission is providing training to managers. It is also establishing new accountability agreements with departments that include values-based performance indicators, such as surveys of client satisfaction, for hiring competent staff in a fair, equitable and transparent manner.

12.43 Clerk of the Privy Council and the appointment of co-champions. In response to this chapter, the Clerk of the Privy Council stated that he has "embraced quite vigorously" the "responsibility for ensuring [that] the values and ethics agenda moves forward." In May 1999 he appointed two deputy minister co-champions to lead the values and ethics agenda. The Privy Council Office (PCO) told us that the appointments do "not preclude the Clerk/PCO from playing a role; however, the responsibility is envisaged as one of support and challenge." The co-champions have focussed on re-activating the values and ethics dialogue and encouraging all deputy ministers to develop ethics initiatives.

12.44 Office of Values and Ethics. In April 1999 the Treasury Board Secretariat established the Office of Values and Ethics. The primary role of the Office is to support the deputy minister co-champions for values and ethics. It is sponsoring the development of training materials, organizing workshops to share best practices, developing case studies, and providing guidance on ethics programs to departments. The Office is also reviewing the Conflict of Interest and Post-Employment Code for the Public Service. Most of this work is in its preliminary stages.

12.45 The Office does not have a mandate to act as an ethics counsellor to public servants or receive or investigate complaints. However, on occasion it is hearing from them and providing advice or taking informal action.

12.46 Secretary of the Treasury Board. In August 1999 the Secretary of the Treasury Board wrote to deputy ministers to clarify the policy and legal framework for public servants regarding the acceptance of gifts, hospitality and other benefits. The Secretary noted that as the government's way of doing business is changing, public servants are increasingly being offered benefits of considerable value. They have indicated that existing codes and guidelines relating to questions of ethical behaviour are vague, and it is not clear to whom they should turn for guidance.

The deputy minister co-champions for values and ethics in the public service have focussed on re-activating the values and ethics dialogue.

12.47 The Secretary emphasized that public servants must understand the legal and policy framework for conflict of interest and its profound legal and professional consequences. He stressed that procedures need to be established to ensure compliance with the requirements of the *Criminal Code* and the Conflict of Interest and Post-Employment Code for the Public Service.

12.48 The Canadian Centre for Management Development. The CCMD contributes to the promotion of values and ethics through its learning activities for public service managers. In February 2000 it established a series of "armchair discussions" on values and ethics, chaired by the co-champions. Values and ethics

are also key elements of the CCMD's leadership and management courses, which are not mandatory.

Major departmental values and ethics initiatives

Departments and their branches are the key organizations for promoting and maintaining sound values and ethics.

12.49 Departments and their branches are the key organizations for promoting and maintaining sound values and ethics. The growing experience with values and ethics initiatives indicates that in a general framework for the public sector, federal entities need to develop initiatives that meet their specific needs.

12.50 For example, National Defence, Public Works and Government Services Canada (PWGSC), and the Royal Canadian Mounted Police (RCMP) have undertaken major initiatives to promote sound values. These initiatives respond to particular circumstances, and they illustrate the variety of challenges and approaches. The values and ethics initiatives in these organizations are sophisticated programs with high expectations, which incorporate and even develop best practices of formal ethics programs. Exhibit 12.4 lists the key elements of these programs.

Exhibit 12.4

Ethics Components of Major Departmental Initiatives

- Leadership activity and participation.
- Extensive dialogue on values and ethics dilemmas in the workplace.
- Grassroots development of values and ethics codes.
- Communication, training and awareness.
- Prompt resolution of ethical concerns.
- Alignment of policies to reinforce ethical decision making.
- Adoption of an ethical decision-making model.
- Recourse options to seek guidance on and report ethical concerns.
- Assessment of cultural change through surveys or focus groups.
- Establishment of a small office for the promotion of ethics.

Source: PWGSC, RCMP, National Defence

12.51 **National Defence.** The Department's values and ethics initiative began from a need to protect resources and later to respond to crises with significant ethical dimensions. The effort has become more comprehensive as the Department and the Canadian Forces have recognized that they are dealing with evermore complex, difficult, and increasingly conflicting and ambiguous operational tasks. In particular, small contingents are being assigned to missions in remote, relatively isolated areas containing populations with a long history of hostilities. In these areas, they are expected to carry out simultaneously military, quasi-police, and peacekeeping functions. These assignments represent a major shift from placing large battle units in the field to fight wars with relatively clear moral rationales and goals.

12.52 **Royal Canadian Mounted Police.** The RCMP's initiative stems from the major change to community policing in 1989. Community policing requires consideration of community expectations, the development of partnerships with community groups, and the provision of tailored services, where possible, to meet the unique needs of each community.

12.53 It also requires a change from a traditional "command and control" organizational and management structure with only one way to do things, "the RCMP way," to one where officers are expected to approach problems by taking into account key problem-solving factors and corporate values and ethics. To implement the approach, the RCMP has appointed an Ethics Advisor. It also has sought to provide a clear rationale, guidance and training, supplemented with a clear statement of departmental commitments to its employees and to the communities it serves. In addition, the RCMP has undertaken a major initiative to align all its policies and procedures with its mission, vision, and values statement.

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12.54 **Public Works and Government Services Canada.** In the fall of 1997 at a meeting of 250 senior departmental executives, the Deputy Minister stated that ethics were part of good governance in the Department. PWGSC has since appointed an ethics counsellor, established a director of an ethics development office, and developed an ethics program framework; the Deputy Minister has distributed terms of reference for the program to each senior manager. Currently, PWGSC is pursuing a major initiative to raise awareness of values and ethics issues through discussion and to support senior management in fulfilling its responsibilities for sustaining values and ethics.

12.55 **Citizenship and Immigration Canada (CIC).** The Department has adopted a step-by-step initiative led by the deputy minister that focusses on the day-to-day promotion of values and ethics. In 1997 it undertook a major consultation initiative with its staff on workplace values and ethics dilemmas and ways of resolving them. The consultations resulted in a resource document, The Ethical Compass: Values and Ethics Dilemmas at CIC.

12.56 The Department has recently approved a framework for middle management training that identifies values as a key area. It has also appointed an ombudsman and a new values and ethics champion. The CIC Ombudsman counsels employees on how to resolve problems, and as a member of the management board, acts as the "conscience of the Department." The Ombudsman reports on general issues to the Deputy Minister, who has made a commitment to act on systemic issues.

12.57 **Other departments.** Human Resources Development Canada (HRDC) has recently begun an extensive dialogue with all staff on values and ethics. The Department has released the Handbook on Values and Ethics in HRDC. All the other departments we reviewed have taken some steps to address values and ethics concerns. For example, all the departments have a vision, mission or values statement. However, most departments have not assigned a high priority to developing comprehensive values and ethics initiatives.

Major Values and Ethics Challenges

A comprehensive effort is needed to ensure that the federal public sector meets emerging values and ethics challenges.

12.58 In our view, a comprehensive effort is needed to ensure that the federal public sector meets emerging values and ethics challenges. To further discussion and action, we have identified specific areas that need to be considered as part of a comprehensive framework of priorities for action. These areas include reinforcing responsibility and leadership for ethical conduct, developing shared values and ethics, and establishing avenues for voicing concerns about values and ethics.

Reinforcing responsibility for ethical conduct

12.59 Sustaining and promoting values and ethics in the federal public sector is the responsibility of all its key institutions and members. It requires a comprehensive approach that involves the leadership and strong commitment of parliamentarians, ministers, and heads of federal entities. It also relies on the development of appropriate values and ethics initiatives in federal entities and in the interaction between the public and private sectors.

Leadership of parliamentarians

12.60 Michael Starr and Mitchell Sharp published a report in 1984, Ethical Conduct in the Public Sector. In it they asked parliamentarians to set an example because they are prominently in the public eye, and their actions, values, and ethical conduct send a signal as to the norms of acceptable behaviour.

12.61 The OECD's Principles for Managing Ethics in the Public Service call

for political and senior official commitment to ethics that reinforces ethical conduct (see Exhibit 12.5).

12.62 Provisions dealing with particular aspects of the conduct of parliamentarians are in various statutes and documents. Relevant sections of the *Criminal Code* cover bribery of officials, fraud against the government, and breach of trust. The *Parliament of Canada Act* contains provisions that govern contracts with the government, the financial interests of senators, and the ineligibility of members of the House of Commons to benefit from government contracts.

12.63 Various attempts have been made, without success, to establish a code of conduct for parliamentarians. In July 1973 the government issued a green paper, Members of Parliament and Conflict of Interest, that proposed a code of conduct for parliamentarians as a first step in implementing a comprehensive policy for officials at all levels of government.

12.64 In June 1992 the Special Joint Committee of the Senate and the House of Commons on Conflict of Interests recommended the adoption of clear rules to guide members of Parliament. In March 1993 the Prime Minister introduced legislation on conflict of interest for parliamentarians. Another committee that reviewed the proposed legislation recommended that it not be pursued. In March 1997 a third special joint committee recommended ethical principles and a code of conduct (see Appendix C). This recommendation reflected the committee's concern about the erosion of the public's respect for Parliament as an institution; Parliament did not adopt it.

12.65 The legislatures of all provinces and territories have adopted conflict-of-interest legislation or codes of conduct that include a requirement for disclosure of assets to an independent commissioner or to the clerk of the legislature. Similarly, national legislatures of similar jurisdictions (such as the United States, the United Kingdom, and Australia) have adopted legislation or standing orders that guide official conduct and require members to disclose assets.

12.66 Given the significance of the need for ethical leadership, we suggest that parliamentarians consider their role once again as part of a comprehensive initiative for the public sector.

Leadership of ministers

12.67 The Prime Minister, other ministers, and the heads of federal entities set the tone for the entire government. In our 1995 Report we indicated that the Conflict of Interest and Post-Employment Code for Public Office Holders, which applies to ministers and Governor-in-Council appointees, was satisfactory. However, explanatory guidelines and illustrative cases are still needed. This information would help parties covered by the Code as well as Canadians to fully understand its application.

12.68 **Ministerial responsibility.** One area that may require further attention is the clarification of the concept of ministerial responsibility. The Tait Report

Exhibit 12.5

Responsibilities of Political Leaders

Principle: Political commitment to ethics should reinforce the ethical conduct of public servants.

Actions

- Maintain a high standard of propriety in the discharge of official duties.
- Create legislative and institutional arrangements that reinforce ethical behaviour.
- Create sanctions against wrongdoing.
- Provide adequate support and resources for ethics-related activities throughout government.
- Avoid exploitation of ethics rules and laws for political purposes.

Source: OECD, Principles for Managing Ethics in the Public Service

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Source: OECD, Principles for Managing Ethics in the Public Service

noted that the concept touches on the "deepest values of public service in a parliamentary democracy" and that if these values are shifting, then "much else is in doubt." It identified concerns among public servants that the concept is unclear, outdated or "just unreal," or "meaningless." The report concluded that because of the evolving nature of parliamentary government and the continuing confusion, it would be useful to develop a clear statement of ministerial responsibility for ministers, public servants and the public.

12.69 Previous government reviews of ministerial responsibility have reached contrary conclusions. For example, the 1962 Royal Commission on Government Organization (Glassco Commission) and the 1979 Royal Commission on Financial Management and Accountability (Lambert Commission) recommended that to reflect reality, deputy ministers should be accountable to Parliament for their administrative responsibilities.

12.70 The Lambert Commission made the recommendation because it had found that "a serious malaise pervading management of government stems fundamentally from a grave weakening, and in some cases an almost total breakdown, in the chain of accountability of government to Parliament and ultimately to the Canadian people."

12.71 In 1991 the Standing Committee on External Affairs and International Trade reviewed the admission of a foreign government official to Canada. The committee concluded that ministerial responsibility should be clarified, and it recommended the immediate appointment of a high-level task force to define the concept.

12.72 Different conclusions can be found in reports from the Privy Council Office that discuss the concept of ministerial responsibility. These reports include the 1979 Privy Council Office submission to the Lambert Commission; the 1990 white paper, Public Service 2000: The Renewal of the Public Service of Canada; the 1992 report, Public Service 2000: A Report on Progress; and the 1993 publication, Responsibility in the Constitution. They argue that the concept is clear — accountability should not be divided because it governs the use of power; thus, "it requires that a minister be *personally* answerable to the House of Commons for the exercise of power."

12.73 Concerns about the clarity of the concept of ministerial responsibility and its consequences are recurrent, and they go to the fundamental nature of responsibility for actions in government. Therefore, we agree with the Tait Report that clarifying the responsibility of ministers is essential for promoting sound values and ethics in government. We would extend this clarification to the responsibility of officials who receive delegated authorities.

Concerns about the clarity of the concept of ministerial responsibility and its consequences are recurrent.

12.74 A starting point for discussion could be for the Privy Council Office to explain the concept of ministerial responsibility so that public servants and the public can better understand the responsibility that exists and how it is respected. Additional starting points for the discussion could be the United Kingdom's Ministerial Code: A Code of Conduct and Guidance on Procedures for Ministers and Australia's Guide on Key Elements of Ministerial Responsibilities.

Leadership in federal entities

12.75 Maintaining sound values and ethics is part of good governance, and senior and middle officials as well as ministers bear the primary responsibility. The OECD's principles call for managers to demonstrate and promote ethical conduct and provide consistent leadership (see Exhibit 12.6). The results of ethical leadership include employees who are more satisfied and committed, organizations that can attract and retain better employees, and organizations that are trusted and more effective.

12.76 The Clerk of the Privy Council, heads of federal entities, and senior and line managers have a key role in promoting a public service based on values. The Tait Report focussed on the importance of the quality of leadership and the calibre of role models, especially at the most senior levels. The role of management is also emphasized in the Treasury Board's March 2000 publication, Results for Canadians: A Management Framework for the Government of Canada. The Board's report states that management in the public service must be guided by a clear set of values. In particular, management must respect and reinforce Canadian institutions of democracy, and it must be guided by the highest professional and ethical standards.

If senior managers want to lead employees effectively, they have to start with promoting values and ethics and leading by example.

12.77 The Clerk has emphasized that everything that senior managers do is judged by their employees. If senior managers want to lead them effectively, they have to start with promoting values.

12.78 We agree with the Clerk and suggest that his approach be taken one step further to clearly specify that the role and responsibilities of heads of entities and senior and line managers include ensuring sound values and ethics in government. This clarification would reinforce the principle that managers should not transfer their responsibilities for maintaining sound values and ethics to such parties as ethics counsellors or ombudsmen. However, managers will need guidance and training to provide this leadership. Exhibit 12.7 summarizes key attributes of ethical leadership.

12.79 There is another prerequisite for success of values and ethics initiatives. Employees in the federal public sector have a key role to play in pushing forward the values and ethics agenda and maintaining the highest standards of values and ethics. However, as the Tait Report stated, public servants and managers will need to be given the tools to assume this role.

Developing Shared Values and Ethics

Statement of public service principles

12.80 Statements of values and ethics are clearly important, but by themselves, they do not create honesty. Their main purpose is often perceived to be to hang on a wall and collect dust. However, as part of a comprehensive approach, we believe such statements can play an important role. They can express the core values of an organization and set standards for acceptable conduct. The core values and standards are those that would not be compromised.

12.81 The Tait Task Force envisioned the development, through extensive dialogue, of a set of clearly articulated and widely endorsed values and ethics principles for the public service one year after the release of its report in 1996. Using these principles, organizations would formulate values and ethics statements that address their specific circumstances.

12.82 The deputy minister co-champions for values and ethics and

Exhibit 12.6

Responsibilities of Managers

Principle: Managers should demonstrate and promote ethical conduct.

Actions

- Demonstrate high standards of conduct.
- Maintain an organizational environment where high standards of conduct are encouraged.
- Provide incentives for ethical behaviour.
- Provide consistent ethical leadership in professional relationships with political leaders, other public servants and citizens.

Source: OECD, Principles for Managing Ethics in the Public Service

the Treasury Board Secretariat have concluded that without an extensive dialogue, the development and implementation of such principles would not be meaningful. This dialogue needs to be transparent and to include discussions with Canadians and specific stakeholders. Without extensive public dialogue, Canadians may be skeptical about the principles and the commitment of leaders to the principles.

12.83 We believe that the federal government needs to set a reasonable time frame for the development of a set of values and ethics principles for the public sector. The United Kingdom's Seven Principles of Public Life (see Appendix D) and Civil Service Code (see Appendix E) could be starting points for discussion. The seven principles apply to all members of the public sector in the United Kingdom. The Code identifies not only the duties and responsibilities of civil servants to ministers but also those of ministers to civil servants.

12.84 As part of a longer-term effort, we believe that the federal government needs to ensure that senior managers discuss, share, and promote a common set of values and ethics. To this end, the Privy Council Office, the Treasury Board Secretariat, and the Canadian Centre for Management Development need to design mandatory training on core values and ethics for all senior managers. This training could be expanded to include all public service managers. The Secretariat would need to ensure that this training is also given to all public servants.

12.85 As well, the Conflict of Interest and Post-Employment Code for the Public Service still needs to be updated. We also recommended in our May 1995 Report that explanatory guidelines and illustrative cases be developed. In June 2000 the Treasury Board Secretariat published a guide on the application of the Code.

Assigning priority to key values and ethics

12.86 Managers and staff in federal entities may encounter a wide range of values and ethics dilemmas in the workplace. Major departmental values and ethics initiatives include developing hypothetical case studies to stimulate discussion. These cases often present situations that pose difficult personal and organizational choices. Exhibit 12.8 illustrates the scenarios that may be discussed. They are taken from the ethics courses of various departments. Participants in the discussion are expected to take a position after identifying the values and ethics at play in the scenario, the risks that exist, and the process that could be used to resolve the situation.

12.87 We are concerned that the discussion of the scenarios may not include clear guidance on the priority to be assigned to the wide range of values and ethics that may apply. The Tait Report identified 45 different values grouped into five overlapping categories of core public service values: democratic values, ethical values, "traditional" professional values, "new" professional values, and people

Exhibit 12.7

Key Attributes of Ethical Leadership in the Public Sector

- **Create a supportive work environment that**
    - values people, treating them with dignity, civility and fairness;
    - emphasizes openness and the sharing of information;
    - promotes honest and collegial leadership;
    - encourages and supports speaking truth to power; and
    - supports a balanced family and work life.
- **Make decisions that**
    - serve the public interest;
    - respect democratic principles and the rule of law;
    - ensure due process, impartiality and objectivity;
    - provide effective services to citizens; and
    - promote transparency, probity and accountability.

Source: Tait Report

better employees, and organizations that are trusted and more effective.

12.76 The Clerk of the Privy Council, heads of federal entities, and senior and line managers have a key role in promoting a public service based on values. The Tait Report focussed on the importance of the quality of leadership and the calibre of role models, especially at the most senior levels. The role of management is also emphasized in the Treasury Board's March 2000 publication, Results for Canadians: A Management Framework for the Government of Canada. The Board's report states that management in the public service must be guided by a clear set of values. In particular, management must respect and reinforce Canadian institutions of democracy, and it must be guided by the highest professional and ethical standards.

If senior managers want to lead employees effectively, they have to start with promoting values and ethics and leading by example.

12.77 The Clerk has emphasized that everything that senior managers do is judged by their employees. If senior managers want to lead them effectively, they have to start with promoting values.

12.78 We agree with the Clerk and suggest that his approach be taken one step further to clearly specify that the role and responsibilities of heads of entities and senior and line managers include ensuring sound values and ethics in government. This clarification would reinforce the principle that managers should not transfer their responsibilities for maintaining sound values and ethics to such parties as ethics counsellors or ombudsmen. However, managers will need guidance and training to provide this leadership. Exhibit 12.7 summarizes key attributes of ethical leadership.

12.79 There is another prerequisite for success of values and ethics initiatives. Employees in the federal public sector have a key role to play in pushing forward the values and ethics agenda and maintaining the highest standards of values and ethics. However, as the Tait Report stated, public servants and managers will need to be given the tools to assume this role.

Developing Shared Values and Ethics

Statement of public service principles

12.80 Statements of values and ethics are clearly important, but by themselves, they do not create honesty. Their main purpose is often perceived to be to hang on a wall and collect dust. However, as part of a comprehensive approach, we believe such statements can play an important role. They can express the core values of an organization and set standards for acceptable conduct. The core values and standards are those that would not be compromised.

12.81 The Tait Task Force envisioned the development, through extensive dialogue, of a set of clearly articulated and widely endorsed values and ethics principles for the public service one year after the release of its report in 1996. Using these principles, organizations would formulate values and ethics statements that address their specific circumstances.

12.82 The deputy minister co-champions for values and ethics and

Exhibit 12.6

Responsibilities of Managers

Principle: Managers should demonstrate and promote ethical conduct.

Actions

- **Demonstrate high standards of conduct.**
- **Maintain an organizational environment where high standards of conduct are encouraged.**
- **Provide incentives for ethical behaviour.**
- **Provide consistent ethical leadership in professional relationships with political leaders, other public servants and citizens.**

Source: OECD, Principles for Managing Ethics in the Public Service

the Treasury Board Secretariat have concluded that without an extensive dialogue, the development and implementation of such principles would not be meaningful. This dialogue needs to be transparent and to include discussions with Canadians and specific stakeholders. Without extensive public dialogue, Canadians may be skeptical about the principles and the commitment of leaders to the principles.

12.83 We believe that the federal government needs to set a reasonable time frame for the development of a set of values and ethics principles for the public sector. The United Kingdom's Seven Principles of Public Life (see Appendix D) and Civil Service Code (see Appendix E) could be starting points for discussion. The seven principles apply to all members of the public sector in the United Kingdom. The Code identifies not only the duties and responsibilities of civil servants to ministers but also those of ministers to civil servants.

12.84 As part of a longer-term effort, we believe that the federal government needs to ensure that senior managers discuss, share, and promote a common set of values and ethics. To this end, the Privy Council Office, the Treasury Board Secretariat, and the Canadian Centre for Management Development need to design mandatory training on core values and ethics for all senior managers. This training could be expanded to include all public service managers. The Secretariat would need to ensure that this training is also given to all public servants.

12.85 As well, the Conflict of Interest and Post-Employment Code for the Public Service still needs to be updated. We also recommended in our May 1995 Report that explanatory guidelines and illustrative cases be developed. In June 2000 the Treasury Board Secretariat published a guide on the application of the Code.

Assigning priority to key values and ethics

12.86 Managers and staff in federal entities may encounter a wide range of values and ethics dilemmas in the workplace. Major departmental values and ethics initiatives include developing hypothetical case studies to stimulate discussion. These cases often present situations that pose difficult personal and organizational choices. Exhibit 12.8 illustrates the scenarios that may be discussed. They are taken from the ethics courses of various departments. Participants in the discussion are expected to take a position after identifying the values and ethics at play in the scenario, the risks that exist, and the process that could be used to resolve the situation.

12.87 We are concerned that the discussion of the scenarios may not include clear guidance on the priority to be assigned to the wide range of values and ethics that may apply. The Tait Report identified 45 different values grouped into five overlapping categories of core public service values: democratic values, ethical values, "traditional" professional values, "new" professional values, and people

Exhibit 12.7

Key Attributes of Ethical Leadership in the Public Sector

- **Create a supportive work environment that**
    - values people, treating them with dignity, civility and fairness;
    - emphasizes openness and the sharing of information;
    - promotes honest and collegial leadership;
    - encourages and supports speaking truth to power; and
    - supports a balanced family and work life.
- **Make decisions that**
    - serve the public interest;
    - respect democratic principles and the rule of law;
    - ensure due process, impartiality and objectivity;
    - provide effective services to citizens; and
    - promote transparency, probity and accountability.

Source: Tait Report

values (see Exhibit 12.9). The report assigned primacy to the values of respect for law and the public interest. However, it did not provide guidance on how to resolve conflicts among competing and overlapping values.

"New" values could be at odds with some of the fundamental requirements of democratic government.

12.88 One of the central concerns of the Tait Task Force was the emphasis being placed on such "new" values as service to clients and customers, as opposed to "traditional" values that focussed on respect for law and accountability. The task force was also concerned that the growing tendency to use the term "customers" or "clients" could have long-term consequences of establishing a new set of standards and a new universe of values. These values could be at odds with some of the fundamental requirements of democratic government.

12.89 The task force's report concluded that any approach that treats the public service, or appears to treat it, as if it were the same as private enterprise risks

Exhibit 12.8

Hypothetical Case Studies of Values and Ethics Dilemmas in the Workplace

Box seats. You are invited by a private sector company to join other departmental personnel in a corporate "box" at a local National Hockey League arena for a game in the Stanley Cup playoffs. You reflect that the cost of these boxes may average to about $100 or more per person in the regular season, but often exceed $1,000 in the playoffs. What should you do?

Request for lenient inspection. You are inspecting the books of a manufacturer that has violated the law. At noon you break for lunch and go to a restaurant. The company manager joins you there and asks you to be lenient regarding the manufacturer's practices and subtly suggests that he could offer you a very good deal on a computer. At the end of the meal, the manager offers to pay for your lunch. What should you do?

Employment offers. You are in a position to recommend and approve giving a contract to a firm that has made overtures to hire you. What should you do?

Missing supplies. You are the supply officer for a peacekeeping mission. On the day that a supply arrives, you are asked to sign for a quantity of 100 of a particular item, when only 70 are in the box. Thirty have been skimmed off as the cost of doing business in this particular country. No signature, no delivery. You need the item badly. What should you do?

Statement of qualifications. You have to prepare a statement of qualifications for a competition and are under pressure from management to write it narrowly so as to favour a particular candidate or to screen out as many candidates as possible in order to speed up the process. What should you do?

Policy advice. A director has prepared a policy statement that you feel contains gross errors and is in some respects dishonest. In spite of staff efforts to correct the mistakes, he continues to push through the policy statement. The easy approach is to keep quiet and implement the new policy; the difficult one is to challenge the accuracy of the document. However, there is no appropriate method to criticize the policy. What should you do?

Building upgrades. Government architects and engineers judge that there is a need for upgrading government-owned buildings. They have identified an opportunity to address the problem during retrofits but were told by financial officers that the funds were not available. They are concerned that the failure to act could make them professionally liable and could embarrass the government should major health problems or injuries occur. What should they do?

Insufficient budget. You are on the review board for a major equipment acquisition project. The project manager is suggesting that the project budget is insufficient to get all the requested equipment, unless auxiliary components are removed from the main project package. You know that once the purchase is decided, the department will have no choice but to find additional funding for the auxiliary components. What should you do?

Managing immigration risks. Your supervisor instructs you to waive all interviews for immigrant applicants listing occupations as either engineers or systems analysts. He believes that the majority of applicants will be accepted, and selection interviews will be of little value. Past experience has shown you that many cases could be problematic. You are reluctant to advise your supervisor because you know that any challenge to his authority will be reflected in your appraisal. What should you do?

Ministerial decisions. In a recent press release, the minister is quoted as saying that a decision will result in significant savings. As a member of the project team, you know this is not quite true. The political interest and involvement in the project was high. To create the savings will require that other projects may have to be delayed or forgone. What should you do?

Peacekeeping situations. You are a platoon commander in a country plagued with sectarian violence and power struggles between the government and rebel factions. Your platoon is ordered to a remote area to evacuate Canadian civilian aid workers from a dangerous situation. At the location, you find that there are many other civilians who are at risk. What should you do?

Source: Ethics courses of PWGSC, National Defence and CIC.

undermining not only the "structure of motivation for public service but, more important, its capacity to serve democratic government in an ethical and accountable manner."

12.90 The Tait Task Force had anticipated the problems encountered in the regulatory and inspection community. A committee of senior officials raised the issue of conflicting values in its November 1999 report, A Public Trust: Keeping Canadians Safe and Healthy, A Review of the Federal Government's Regulatory/Inspection Community: Recruitment, Retention and Management Issues. The committee noted that client-service values increasingly involve inspectors in educating, persuading, and monitoring industry as well as enforcing regulations. These responsibilities require inspectors to build a relationship of mutual trust with industry clients and to create a collaborative atmosphere of learning and development. The dual role is considerably more complex and introduces "tensions into the relationship, requiring the inspector to make appropriate choices between the 'white' hat (service role) and the 'black' hat (enforcer role)."

12.91 According to the committee's report, the regulatory and inspection community has found it difficult to interpret the meaning, in its operational context, of the "client service" vocabulary prevalent in the government over the past five years. The report concluded that "a key issue to be addressed is the need to shift the vocabulary for this group from the 'client service' vocabulary, toward a discussion of 'Protecting the Public Interest'."

Exhibit 12.9

Categories of Values

Democratic values	• Responsible government • Rule of law • Support for democracy • Respect for the authority of elected officeholders	• Loyalty • Neutrality/non-partisanship • Accountability • Due process • Public interest/common good
"Traditional" professional values	• Neutrality/non-partisanship • Merit • Excellence • Effectiveness • Economy • Frankness	• Objectivity and impartiality in advice • Speaking truth to power • Balancing complexity • Fidelity to the public trust
"New" professional values	• Quality • Innovation • Initiative • Creativity	• Resourcefulness • Service to clients/citizens • Horizontality • Teamwork
Ethical values	• Integrity • Honesty • Probity • Prudence • Impartiality	• Equity • Selflessness • Discretion • Public trust
People values	• Respect • Concern/caring • Civility/courtesy • Tolerance • Openness • Collegiality/participation	• Fairness • Moderation • Decency • Reasonableness • Humanity • Courage

Source: Tait Report

"New" values could be at odds with some of the fundamental requirements of democratic government.

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Source: Tait Report

12.92 The report noted that "the focus on Client Service has been driven by a wide range of government initiatives and directives, providing a persuasive message to all public servants." It suggested that "a renewed focus on the public interest could be initiated through the development of a 'Code of Practice' applying specifically to the 'regulatory/inspection function'."

12.93 The Regulatory Inspection Secretariat at Transport Canada told us that it is currently consulting inspectors from various departments on their role. The Secretariat is also asking them about the potential tools, such as a code of conduct, that would put more emphasis on protecting the public interest.

12.94 Although the emphasis on "new" values raises concerns, it also presents potential benefits. The Tait Task Force suggested that the right balance of "traditional" and "new" values could reduce bureaucratic preoccupation with territory and narrow perspectives and help to recognize citizens and their interests as real and concrete. This balance could create a strong culture of public service.

It should be made clear that the public service values of respect for law and the public interest are paramount.

12.95 In practice, we believe that the "traditional" public service values have always included elements of the "new" values. These types of values do not represent a dichotomy. The crux of the concern is whether the "new" values are being interpreted as having a higher priority than such key "traditional" values as respect for law and the public interest.

12.96 The Tait Task Force recognized that there was confusion, tension, and conflict between "traditional" and "new" values. As a result, it recommended in its report that the dialogue on public service values and ethics be used to explain and provide guidance on finding the right balance of "new" values and "traditional" values. However, like the Tait Task Force, we believe that it should be made clear that the public service values of respect for law and the public interest are paramount.

Immediate steps to reinforce ethical decision making

12.97 Because a wide-ranging dialogue is required, the development of a set of core principles may take some time. Federal entities can take immediate steps to establish elements of the infrastructure needed to help staff manage and deliver programs ethically. The establishment of this infrastructure would indicate to staff that senior management is taking seriously current values and ethics initiatives.

12.98 The initial step is to acknowledge the difficult value and ethical judgments that may have to be made in delivering programs. Employees who have been told to make judgment calls need to have the necessary guidance and support. Judgment involves consciously asking if decisions and the reasons for the decisions are fair, honest, and reputable and would bear close public scrutiny if the media disclosed them.

12.99 To help make judgments, departments could adopt a decision-making model to help managers and staff manage ethically (such a model is already part of three departmental ethics initiatives that we reviewed). They also could establish program support centres, which would offer objective guidance to staff and complement the role of superiors. As well, they could use their risk management programs to assist staff in predicting and planning for difficult situations. For example, the management of the Real Property Service of PWGSC has focussed on developing a support centre and risk management techniques. Without them, it believes that asking staff to take risks and apply ethical values "will be seen cynically as an attempt by management to download its responsibilities on staff."

Guidance for interaction between the public and private sectors

12.100 A shared set of values is a necessary condition for a successful business relationship. In our May 1995 Report, we concluded that "the government needs to forthrightly communicate its core set of ethical standards to groups and individuals dealing with government with a clear indication that it expects these standards to be respected." As well, the OECD's principles call for "clear guidelines for interaction between the public and private sectors." A prerequisite for dealing with this issue is the development of a clear set of values and ethics government-wide and in relevant federal entities.

12.101 Major steps have been taken to address this issue for lobbyists. In September 1988 the *Lobbyists Registration Act* was promulgated. In March 1997 the Ethics Counsellor, by regulation, established the Lobbyists' Code of Conduct to provide greater assurance to Canadians of the integrity, objectivity, and impartiality of government decision making.

12.102 In the relationship between the public and private sectors, including voluntary agencies, billions of dollars are spent on contracts as well as grants and contributions in Canada and abroad. However, the relationship has become increasingly complex as the government establishes alternative service delivery entities, which operate in a manner similar to companies, and as it creates partnerships with the private sector to pursue the public interest. In addition, the government has privatized certain public functions that still serve public purposes.

12.103 While the public and private sectors share many values, they differ in key respects. For example, personal financial interests in the private sector are often tied to the interests of the corporation through benefits such as share options, and political neutrality is not required. Also, with consent, personal information about customers may be shared to reduce financial risks. In the public sector, employees are expected to act in the public interest and remain politically neutral. They are also obligated to protect the privacy of personal and corporate information provided to the government.

12.104 We found that the private sector is aware of the need to establish guidelines to govern the interaction between itself and the public sector. Some major companies have such guidelines.

12.105 The Australian Department of Defence has published a code of conduct setting out a framework for relationships between itself and industry. The code contains 17 principles, some of which require honesty and integrity, action with care and diligence, and accountability for decisions and actions. According to the Department, it "expects that its tenderers, contractors, suppliers and their employees and subcontractors will all be guided by this Code of Conduct." If departmental or industry employees believe that a breach of law or of ethical behaviour has occurred, they can report their concerns to the Department's Inspector-General, who will investigate in confidence.

In its Principles for Managing Ethics in the Public Service, the Organization for Economic Co-operation and Development calls for "clear guidelines for interaction between the public and private sectors."

12.106 In our view, there is a need to develop with appropriate stakeholders a set of principles that clarify values and ethics for public servants in alternative service delivery agencies and in partnerships with the private sector. Similarly, there is a need to clarify values and ethics that guide relationships with contractors and recipients of grants and contributions.

12.107 Core principles could be customized and built into contracts and grant and contribution agreements. They could also be made part of legislation that establishes alternative service delivery agencies and privatizes public functions. As well, proactive due diligence is needed prior to signing contracts and agreements. The "ripple" effect of such an effort on

maintaining honesty could be considerable. Exhibit 12.10 presents possible elements for guiding interaction between the public and private sectors.

Objective assessment and reporting

12.108 One of the key areas that federal entities will need to examine is how best to report on values and ethics. Entities will need to objectively demonstrate and report to Parliament, as part of good governance, that they have an ethical culture and that their values and ethics initiatives are effective. Such an assessment will also have to present stakeholder and public concerns about program credibility.

The Tait Task Force concluded that unless recourse mechanisms were created, many public servants would consider all the talk about values and ethics as "so much hot air."

Voicing Values and Ethics Concerns

Good-faith intervention

12.109 Good-faith intervention recognizes that it is important for the health of an organization to provide an effective range of options for expressing individual dissent and ethical concerns. A comprehensive approach to values and ethics comprises recourse options that allow employees to intervene in good faith.

Exhibit 12.10

Possible Set of Principles for Interaction Between the Public and Private Sectors

- Respect the law, contracts and agreements.
- Ensure no conflicts of interest.
- Respect the public service value of acting in the public interest.
- Support common values such as
  - being honest, open and co-operative
  - being equitable and fair
  - standing behind commitments
  - treating people fairly
  - proactively protecting the environment
  - mutually contributing to doing things better.
- Maintain high performance standards such as
  - exceptional quality
  - competitive pricing
  - superior product support
  - on-time delivery
  - continuous improvement
  - procedures that ensure compliance with the law and codes.

Source: Tait Report, PWGSC and Canadian private sector companies

12.110 Public servants have legislative and non-legislative avenues for raising specific concerns. These avenues include communicating matters to specialized agencies such as the Commissioner of Official Languages and the Canadian Human Rights Commission, appealing staffing decisions, and raising issues with supervisors.

12.111 However, public servants told the Tait Task Force that there was no point in asking them to uphold public service values or maintain high ethical standards if they were not given the tools to do so. The task force concluded that unless recourse mechanisms were created, many public servants would consider all the talk about values and ethics as "so much hot air." Thus, it recommended that a senior independent authority be established to receive reports confidentially and act in a fair and impartial manner.

12.112 The Public Service Alliance of Canada and the Professional Institute of the Public Service of Canada have recommended the adoption of "whistle-blowing" legislation. The Association of Professional Executives of the Public Service of Canada has recommended the establishment of an ombudsman for senior executives.

12.113 Establishing recourse for good-faith intervention is a difficult challenge, but one that needs to be addressed. Our May 1995 Report called for a thorough discussion of the advantages and disadvantages of alternative approaches that allow individuals to intervene in good faith. The OECD reached similar conclusions.

12.114 There is a growing number of precedents that provide insight on how to implement the recommendation of the Tait Report. The ethics initiatives of National Defence, PWGSC and the RCMP seek to maintaining honesty could be considerable. Exhibit 12.10 presents possible elements for guiding interaction between the public and private sectors.

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    - **exceptional quality**
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12.115 New Brunswick has included general protection in its 1988 amendments to the *Employment Standards Act.* In 1998 Nova Scotia adopted a *Whistleblowers Act* that allows employees to disclose information about government wrongdoing to the Province's ombudsman and protects those who do so. The March 1999 *Canadian Environmental Protection Act,* the August 1999 amendments to the federal *Competition Act,* and the April 2000 *Personal Information Protection and Electronic Documents Act* provide authority and protection for employees who report alleged violations of the Acts to designated officials. Since 1980, members of Parliament have introduced several private members' bills to provide similar authority to federal public servants. The most recent proposed legislation is Bill C-239 in the House of Commons and Bill S-13 in the Senate.

12.116 Other national jurisdictions have enacted "whistle-blowing" legislation. The United States passed the *Whistleblower Protection Act* in 1989. Australia amended its public service regulations in 1998 to allow the reporting of breaches of the Australian Public Service Code of Conduct to its Public Service Commissioner, with appropriate protection. In the same year, the United Kingdom passed a detailed *Public Interest Disclosure Act* to provide for disclosures in good faith of a wide range of ethical concerns. These approaches vary in their requirements for raising concerns internally before they can be brought to the attention of an independent party. Thus, the relevance of experience in other jurisdictions needs to be assessed.

12.117 The Privy Council Office believes that "in fact, there is little empirical evidence to suggest that there is a large unaddressed problem, suggesting that it might be better to establish what, if any, problem may exist before moving forward with new recourse mechanisms."

12.118 However, in our view, there is a consensus that work has to be done in Canada's federal public sector to allow the voicing of ethical issues with appropriate protection for all concerned. We believe that this issue will not go away and it needs to be addressed as part of a comprehensive approach.

Ombudsmen

12.119 Seven federal departments have ombudsmen, but for the most part, their role is to impartially provide employees with informal, confidential support in dealing with difficult work situations. Only the National Defence Ombudsman and the Office of the Correctional Investigator have mandates to investigate complaints.

Eight Canadian provinces, the United Kingdom, Australia and New Zealand have ombudsmen.

12.120 Eight provinces (including Ontario, Quebec, Alberta, and British Columbia) and one territory have ombudsmen, who are officers of the legislature. Their role is to promote fairness and administrative accountability through the investigation of complaints about abuses resulting from acts or omissions of government organizations. The United Kingdom, Australia, and New Zealand also have created offices of legislative ombudsmen to investigate complaints about administrative actions of government.

12.121 Canada does not have a federal ombudsman. However, a committee of deputy ministers recommended the establishment of this position to the Prime Minister in July 1997. In June 1999 the Canadian Ombudsman Association called for the creation of a federal ombudsman so that Canadians would "be able to exercise their democratic right to an independent review and investigation when they believe their right to fair treatment has been infringed by federal public agencies."

Exhibit 12.11

Best Practices and Benchmarks

Leadership

Heads of organizations and senior managers are trained in values and ethics and are expected to educate their staff and encourage discussion of values and ethics dilemmas in the workplace.

Managers are responsible for leading focus group sessions to explain the statement of values and ethics and any codes of conduct, mentoring for leadership based on sound values and ethics, and generating discussion of values and ethics.

Over time, different managers and staff are selected on the basis of their reputations for ethical conduct to lead ethics initiatives in their units and be a source of guidance.

Managers are responsible for discussing any conflict-of-interest code with their employees before employees are asked to sign a statement that they understand and are in compliance with the code. Managers and employees are responsible for signing a statement that such a discussion has occurred.

More stringent conflict-of-interest declarations are used at increasingly senior management levels.

Appraisals of senior managers and potential senior managers include an assessment by their superiors and staff of whether they are leading by example.

Statements of values and ethics

These statements

- recognize that most employees have sound values and ethics;
- reflect extensive consultation at all levels of the organization, but especially with middle managers;
- are clear, succinct, and relevant to the organization;
- are approved and supported at the highest levels of the organization;
- recognize that loyalty and trust is a two-way street and contain explicit commitments to employees;
- provide detailed explanations, case studies, and guidance;
- subscribe where possible to recognized national or international standards;
- contain explicit provisions for guiding interaction between the public and private sectors;
- apply to contractors, suppliers, and recipients of funding; and
- specify consequences of non-compliance.

Management policies

Establish a clear policy empowering front-line employees to take ownership of a conflict or problem and to resolve it quickly and efficiently.

Establish infrastructure such as a decision-making model that explicitly requires consideration of values and ethics.

Establish formal procedures to align all management policies against the values and ethics of the organization.

Guidance and training

Provide a decision-making model that includes values and ethics.

Establish integrated program support services.

Develop facilitators and design training programs.

Develop case studies of work dilemmas.

Develop information resources that managers can use to discuss values and ethics with their staff.

Obtain advice from qualified professionals.

Place all information relating to values and ethics on the organization's intranet and Web sites.

Good-faith intervention

Establish a range of options for employees to seek advice and resolve issues, including ombudsmen, ethics advisors, confidential help lines, and alternative dispute resolution procedures.

Clearly require managers to proactively address values and ethics incidents rather than wait until an employee takes the initiative.

Clearly state the responsibilities of employees when they become aware of questions of values and ethics as well as wrongdoing, and make formal commitments to protect employees who report wrongdoing.

Require suppliers of goods and services to report issues relating to values and ethics.

Treat infractions and wrongdoing fairly and uniformly.

Assessment and reporting

Report publicly against highest relevant organizational, national, or international standards.

Share information to establish benchmarks.

Periodically conduct employee focus groups or surveys to assess perceptions of values and ethics and the effectiveness of training and communication.

Conduct focus groups or surveys of stakeholder confidence in the organization.

Conduct audits to assess progress in establishing a sound infrastructure to support values and ethics in various parts of the organization.

Source: Federal government departments and Canadian private companies

Using Best Practices

12.122 For this study we have identified the best practices and benchmarks for promoting values and ethics (see Exhibit 12.11). The practices are based on our review of activities in 10 government departments and practices in over 20 leading Canadian companies. These practices serve as benchmarks to help parliamentarians assess government values and ethics initiatives and to help ministers and federal entities develop and implement effective efforts to promote values and ethics in the public sector.

Conclusion

12.123 Canadians expect that the federal public sector will be a world leader in promoting sound values and ethics in government. Ensuring sound values and ethics is a vital part of good governance that supports and respects fundamental democratic values.

12.124 In this study, we focussed on values and ethics programs and initiatives that promote ethical decision making as part of a comprehensive approach to good governance in federal entities. We noted the following:

- values and ethics initiatives are being undertaken to maintain probity;
- to increase the likelihood of success, values and ethics initiatives have to be carefully developed, implemented, and monitored using the best available practices;
- the initiatives have to be part of a comprehensive effort involving Canadians and all members of the federal public sector; and
- leadership and action by parliamentarians, ministers and senior officials are a prerequisite for the success of these initiatives.

12.125 Changes in government have made it clear that ensuring probity will increasingly rest on a strong foundation of values and ethics. Our May 1995 Report and the Tait Report concluded that there is a sound base of ethical standards among federal public servants. This foundation should not be taken for granted. Measures are being taken to maintain it. Although mostly in their preliminary stages, major values and ethics initiatives are under way.

Priorities and a framework for action

12.126 A comprehensive and sustained dialogue with Canadians and throughout the federal public sector is required. To further discussion with Canadians and throughout the federal public sector and to encourage action, we propose priorities and a framework for action (see Exhibit 12.12). The priorities reflect the major values and ethics challenges that we discussed in this chapter.

12.127 We suggest the following eight priorities for action.

- Reinforce leadership for promoting ethical conduct by, for example,
    - clarifying the principle of ministerial responsibility and the responsibilities of officials; and
    - identifying the responsibilities of senior and line managers for promoting sound values and ethics.
- Re-invigorate an extensive dialogue on values and ethics that emphasizes the primacy of the principles of respect for law, the public interest, and public service as a public trust.
- Develop a statement of values and ethics for the federal public sector and for each federal entity.
- Develop a set of values and ethics to guide the interaction between the public and private sectors.

(continued on page 12–30)

Canadians expect that the federal public sector will be a world leader in promoting sound values and ethics in government.

Exhibit 12.12

Framework for Action

OECD principles	Actions	Primary responsibility
Leadership		
Political commitment to ethics should reinforce the ethical conduct of public servants.	Reinforce political leadership for ensuring integrity in the federal public sector.	Parliamentarians, ministers
	Affirm the paramount importance of democratic values, the rule of law and public trust.	Parliament, ministers, Clerk of the Privy Council, heads of federal entities, co-champions for values and ethics, senior public servants, private sector
	Re-invigorate an extensive dialogue on values and ethics with Canadians and throughout the federal public sector.	
	Develop a set of common values and ethical principles with Canadians for the public sector.	
	Align all systems and policies to support sound public service values and ethics.	
	Clarify the principle of ministerial responsibility and the responsibilities of officials to whom authority has been delegated.	Ministers, Privy Council Office
Managers should demonstrate and promote ethical conduct.	Identify the Clerk of the Privy Council, as Head of the Public Service, and the deputy minister co-champions as the officers responsible for ensuring that values and ethics initiatives are undertaken in the public service.	Prime Minister
	Identify the heads of federal entities as accountable for ensuring that comprehensive values and ethics initiatives are undertaken in their entities.	Clerk of the Privy Council
	Identify and emphasize the responsibilities of senior and line managers for promoting integrity.	Heads of federal entities, Public Service Commission, Treasury Board
Public service conditions and management of human resources should promote ethical conduct.	Based on the appraisals from superiors and staff, hire and promote senior managers who lead by example.	Heads of federal entities, Public Service Commission, Treasury Board
Ethical standards		
Ethical standards for public service should be clear.	Emphasize the principle of public service as a public trust and the primacy of the public interest and the law.	Parliamentarians, ministers, heads of federal entities, Privy Council Office
	In consultation with Canadians, use the set of common principles as a basis for the development of statements of values and ethics that address the specific circumstances of each organization.	Parliamentarians, ministers, heads of federal entities, Privy Council Office
	Explain and balance competing public service values so that the public interest remains the paramount principle.	Privy Council Office, co-champions for values and ethics, Treasury Board
	Reinforce the integrity and credibility of the federal scientific and technology community and the regulatory and inspection community.	Privy Council Office, heads of scientific and regulatory entities

Exhibit 12.12 (cont'd)

OECD principles	Actions	Primary responsibility
Ethical standards (cont'd)		
Ethical standards should be reflected in the legal framework.	Provide mandatory training to senior managers on the promotion of values and ethics.	Privy Council Office, Treasury Board, Canadian Centre for Management Development
Appropriate procedures and sanctions should exist to deal with misconduct.	Identify, integrate, and revise, as needed, the basic legal requirements for ethical conduct.	Parliamentarians, Privy Council Office, Department of Justice
	Explain to all members of the federal public sector the general and specific laws and policies relating to improper conduct.	Heads of federal entities, Treasury Board
Interaction between the public and private sectors		
There should be clear guidelines for interaction between the public and private sectors.	Develop a set of values and ethics to guide interaction between the public and private sectors.	Privy Council Office, Treasury Board
	Embed key ethics code elements in contracts and agreements on grants and contributions.	Privy Council Office, Treasury Board, Public Works and Government Services Canada
	Require organizations that wish to do business with the government or receive public funds to have a code of conduct or subscribe to a model code.	Privy Council Office, Treasury Board, Public Works and Government Services Canada
	Require proactive due diligence prior to signing contracts and agreements.	Public Works and Government Services Canada, heads of federal entities
Decision making		
Ethical guidance should be available to public servants.	Establish a variety of options government-wide and in entities to provide guidance, e.g., ethics counsellors and ombudsmen.	Privy Council Office, Treasury Board, heads of federal entities
	Develop guidelines and case studies that address dilemmas faced at work.	Privy Council Office, Ethics Counsellor, Treasury Board, heads of federal entities
	Clarify the meaning of existing codes of conduct or conflict of interest such as the *Conflict of Interest and Post-Employment Code for Public Office Holders* and the *Conflict of Interest and Post-Employment Code for the Public Service.*	Privy Council Office, Ethics Counsellor, Treasury Board, heads of federal entities
The decision-making process should be transparent and open to scrutiny.	Establish integrated program support centres and a decision-making model that explicitly requires transparency and the consideration of values and ethics.	Privy Council Office, Treasury Board, heads of federal entities
Public servants should know their rights and obligations when exposing wrongdoing.	Develop clear and effective recourses for good-faith intervention.	Treasury Board, heads of federal entities, Privy Council Office

Exhibit 12.12 (cont'd)

OECD principles	Actions	Primary responsibility
Decision making (cont'd)		
Management policies, procedures, and practices should promote ethical conduct.	Establish a clear policy empowering front-line employees to take ownership of a conflict or problem and to resolve it fairly and efficiently.	Treasury Board, heads of federal entities
	Align organizational management policies to support ethical decision making.	Treasury Board, heads of federal entities
	Include commitments to employees in statements of values and ethics.	Treasury Board, heads of federal entities
Assessment and reporting		
Adequate accountability mechanisms should be in place in the public service.	Conduct periodic baseline assessments of values and ethics in federal organizations, including assessments by Canadians and specific stakeholders.	Treasury Board, heads of federal entities
	Report to Parliament and the public on the effectiveness of values and ethics initiatives.	Treasury Board, heads of federal entities

(continued from page 12–27)

- Establish comprehensive values and ethics initiatives in federal entities and interdepartmental communities.

- Provide guidance for ethical decision making and develop recourse mechanisms to allow the voicing of ethical concerns, with appropriate protection for all concerned.

- Explain to all members of the federal public sector the general and specific laws and policies relating to improper conduct.

- Provide objective assessments and reports to Parliament on values and ethics in federal entities.

12.128 The federal government needs to develop an implementation plan with deadlines to address values and ethics priorities across the public sector and in federal entities. We will continue to monitor and report to Parliament on values and ethics initiatives in the federal public sector.

Response of the Privy Council Office: *The Auditor General is to be commended for choosing to study what most public servants acknowledge as some of the keys to the success of the federal public service, that is, its values and ethics.*

As the study notes, the report of the task force led by John Tait, A Strong Foundation: Report of the Task Force on Public Service Values and Ethics, marked an important moment in our understanding of the role that values and ethics play in our organization. More important, as this report and others noted, the Public Service of Canada is known and respected for the values and integrity that public servants exhibit in the work they do. In effect, we are able to discuss values and ethics because of the common ground that public servants share in this regard. Many of the best practices highlighted in the Auditor General's study provide further evidence of this fact and the vigour that we display in advocating further work in this area.

Nevertheless, let us be clear — more work needs to be done and will be done. New policies that deal with values and ethics are being developed and shared. The dialogue that is so fundamental to these efforts is taking place and will do so increasingly. More than ever, departments *are sharing their values and ethics best practices, and the values and ethics co-champions are providing leadership and direction that will ultimately ensure our success in these efforts.*

This study makes significant strides in highlighting the important role to be played by elected and non-elected officials. However, it is important to underscore that true success in promoting values and ethics as key underpinnings of the culture of the federal public service can only occur with the involvement and commitment of all public servants. This study makes a strong contribution in this regard and will no doubt help serve to invigorate and counsel our efforts.

Response of the deputy minister co-champions for values and ethics in the public service: *We are satisfied that the chapter corresponds with our own assessment of work under way to deepen understanding of values and ethics in the federal public service. There is growing awareness and interest in the links with modern comptrollership and human resource management frameworks, and the dialogue is expanding across the public service. Deputy ministers and other senior officials are fully engaged. Dialogue is important to build understanding, and the activities under way in departments and under the auspices of regional councils are supportive of our overall objectives.*

Response of the Secretary of the Treasury Board: *The chapter corresponds with my own assessment of work under way to further understanding of values and ethics in the public service and to underscore the linkages to modern comptrollership and human resource frameworks. I am pleased with the growing dialogue that is taking place on this important subject. It is a fine tribute to the work of John Tait and the report of his task force, A Strong Foundation.*

Current efforts in support of the dialogue recognize the many benefits of engaging employees at all levels in discussions about the values of the organization and the ethical dilemmas one can encounter in the workplace. The deputy minister co-champions of values and ethics in the public service have described the dialogue as a journey. The experience of the journey will touch many public servants, and in many ways, the journey is as important as the destination.

This dialogue will provide us with a strong foundation for considering the merits of any formal statement on values and ethics. The dialogue will also help us to address related issues like the need to consult more broadly with Canadians and how best to provide guidance on ethical decision making.

In closing, I would congratulate the Auditor General's staff on the thoroughness of its research and the very professional manner in which it undertook this study.

Response of the Ethics Counsellor: *Paragraph 12.67 of the chapter notes that the Auditor General's 1995 Report found the Conflict of Interest and Post-Employment Code for Public Office Holders to be satisfactory but that "explanatory guidelines and illustrative cases are still needed. This information would help parties covered by the Code as well as Canadians to fully understand its application." I agree with this statement and have two principal comments to make.*

First, let me recall that the Conflict of Interest Code, in its current version, was issued by the Prime Minister in June 1994. One of the more important changes was to give prominence to the principles by which public office holders are to be guided in carrying out their responsibilities. From these principles a number of rules have been developed, covering assets, outside activities, gifts, etc. But it is the principles that provide the broad context about what is expected of those in public life. This Code applies to the Cabinet, parliamentary secretaries, minister's political staff and all Governor-in-Council appointees, including deputy *ministers, the heads of agencies and the members of tribunals such as the Immigration and Refugee Board and the Canadian Radio-Television and Telecommunications Commission.*

There are ten principles, but I would highlight the first two. The first principle states that public office holders "shall act with honesty and uphold the highest ethical standards so that public confidence and trust in the integrity, objectivity and impartiality of government are conserved and enhanced." The second principle takes this further by stating that public office holders have "an obligation to perform their official duties and arrange their private affairs in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law." It is my experience that the Code has worked well by stating so explicitly to public office holders what is expected of them.

My second comment is directed to the Auditor General's recommendation for explanatory guidelines and illustrative cases. I believe that the most effective way to disseminate information on the Code and its obligations is through the Internet. As a result, my office has been actively developing a Web site, which can be found at http://strategis.ic.gc.ca/ethics (http://strategis.ic.gc.ca/éthique). Currently, the site has the Code and supporting documents, the public registry as well as the text of parliamentary hearings, reports and speeches issued by my office. The Internet makes the Code more accessible to public office holders and, more important, to Canadians. It is my hope that our site will be greatly expanded over the next year.

About the Study

Objective

Our objective is to stimulate sustained discussion and action on values and ethics by Canadians and members of the federal public sector.

In this chapter we review major values and ethics initiatives undertaken since our May 1995 Report to Parliament, present information on best practices for promoting sound values and ethics and propose priorities and a framework for government action.

Scope and Approach

We focussed on values and ethics programs and initiatives that promote ethical decision making. Because maintaining probity is the responsibility of all members of the federal public sector, we included within the scope of the study parliamentarians, ministers, federal entities, and organizations and individuals that receive funds from or do business with the public sector.

We obtained information on the major values and ethics initiatives undertaken since our May 1995 Report in the Treasury Board Secretariat, National Defence, the Royal Canadian Mounted Police, Public Works and Government Services Canada, Citizenship and Immigration Canada, Human Resources Development Canada, the Canada Customs and Revenue Agency, Natural Resources Canada, Agriculture and Agri-Food Canada, Industry Canada, the Canadian International Development Agency, and the federal science and technology sector.

We also obtained information on values and ethics initiatives in major Canadian companies.

We did not conduct an in-depth assessment of the effectiveness of these initiatives in changing attitudes and behaviour because most of them are in their early stages of development. Also, to be meaningful, such assessments would have to be done for each department or branch. (For example, we assessed existing values and ethics initiatives of Revenue Canada in our September 1998 Report, Chapter 15, Promoting Integrity in Revenue Canada, and of National Defence in our November 1999 Report, Chapter 26, The Proper Conduct of Public Business.)

The topic of values and ethics is very broad. There are important subjects we did not cover, such as the values and ethics concerns regarding human rights, sexual harassment, diversity, and employment equity.

Criteria

As the primary criteria for this study, we used the OECD's Principles for Managing Ethics in the Public Service:

- Ethical standards for public service should be clear.
- Ethical standards should be reflected in the legal framework.
- Ethical guidance should be available to public servants.

- Public servants should know their rights and obligations when exposing wrongdoing.
- Political commitment to ethics should reinforce the ethical conduct of public servants.
- The decision-making process should be transparent and open to scrutiny.
- There should be clear guidelines for interaction between the public and private sectors.
- Managers should demonstrate and promote ethical conduct.
- Management policies, procedures and practices should promote ethical conduct.
- Public service conditions and management of human resources should promote ethical conduct.
- Adequate accountability mechanisms should be in place within the public service.
- Appropriate procedures and sanctions should exist to deal with misconduct.

We also used major government and private sector values and ethics initiatives as benchmarks to conduct this study.

Finally, we considered the observations and recommendations of major federal public sector reports, namely the following:

- the 1984 report by Michael Starr and Mitchell Sharp, Ethical Conduct in the Public Sector;
- our May 1995 Report, Chapter 1, Ethics and Fraud Awareness in Government; and
- the 1996 report, A Strong Foundation: Report of the Task Force on Public Service Values and Ethics (Tait Report).

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Appendix A

Possible Elements of an Ethical Framework Proposed in Our May 1995 Report

A statement of principles to ensure common understanding that public service is a public trust.

Leadership of the Prime Minister, ministers, the Clerk of the Privy Council and deputy ministers to maintain ethical standards.

Public servants who are empowered to carry out their duties in the public interest and resist pressure to do otherwise.

Transparent decision making to allow people to judge whether public office holders are acting in the public interest.

Ethics-related training to develop knowledge and skills to maintain and enhance ethics.

A mechanism for discussing and reporting ethical concerns so that public servants can voice concerns without fear of reprisal.

A continuous process that makes ethics a conscious and visible part of day-to-day decision making.

Appendix B

Major Values and Ethics Initiatives Since Our May 1995 Report

May 1995	The Auditor General presents his Report to Parliament, which includes Chapter 1, Ethics and Fraud Awareness in Government.
June 1996	The Royal Canadian Mounted Police completes the shared leadership vision process.
October 1996	National Defence publishes a Statement of Defence Ethics.
December 1996	The Tait Task Force publishes A Strong Foundation: Report of the Task Force on Public Service Values and Ethics.
March 1997	The Ethics Counsellor establishes the Lobbyists' Code of Conduct.
October 1997	A report on modernizing government comptrollership recognizes the importance of values and ethics.
October 1997	Public Works Government Services Canada initiates a comprehensive ethics program.
April 1998	The Organization for Economic Co-operation and Development adopts its Principles for Managing Ethics in the Public Service.
December 1998	Citizenship and Immigration Canada (CIC) issues The Ethical Compass: Values and Ethics Dilemmas at CIC.
January 1999	The federal government initiates a project on best practices for managing science in the public sector.
February 1999	The *Corruption of Foreign Public Officials Act* is promulgated.
April 1999	The Treasury Board Secretariat establishes the Office of Values and Ethics.
May 1999	Deputy minister co-champions for values and ethics are appointed.
May 1999	The Council of Science and Technology Advisors publishes Science Advice for Government Effectiveness.
June 1999	Canada signs the Inter-American Convention Against Corruption.
August 1999	The Treasury Board emphasizes the need for public servants to understand the legal and policy framework for conflict of interest.
January 2000	The Canadian Centre for Management Development re-issues A Strong Foundation: Report of the Task Force on Public Service Values and Ethics.
January 2000	Deputy minister co-champions for values and ethics meet deputy ministers.
March 2000	The Treasury Board's report, Results for Canadians: A Management Framework for the Government of Canada, recognizes the importance of sound public service values.
March 2000	In the Seventh Annual Report to the Prime Minister on the Public Service of Canada, the Clerk of the Privy Council emphasizes the role of public service values.
Spring 2000	The Leadership Network reports on the values and ethics dialogue in the public service.

Appendix C

Purposes and Principles of the Code of Official Conduct Recommended by the 1997 Special Joint Committee of the Senate and the House of Commons

The purposes of the Code of Official Conduct are the following:

1. to recognize that service in Parliament is a public trust;

2. to maintain public confidence and trust in the integrity of parliamentarians individually and the respect and confidence that society places in Parliament as an institution;

3. to assure the public that all parliamentarians are held to standards that place the public interest ahead of parliamentarians' private interests and to provide a transparent system by which the public may judge this to be the case;

4. to provide for greater certainty and guidance for parliamentarians in how to reconcile their private interests with their public duties;

5. to foster consensus among parliamentarians by establishing common rules and by providing the means by which questions relating to proper conduct may be answered by an independent, non-partisan advisor.

All parliamentarians are expected to uphold the following principles.

1. **Ethical standards**

Parliamentarians shall/should act with honesty and uphold the highest ethical standards, so as to maintain and enhance public confidence and trust in the integrity of each parliamentarian and in the institution of Parliament.

2. **Public scrutiny**

Parliamentarians shall/should perform their official duties and arrange their private affairs in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law.

3. **Independence**

Parliamentarians shall/should take care to avoid placing themselves under any financial or other obligation to outside individuals or organizations that might influence them in the performance of their official duties. Particular vigilance should be exercised in dealings with lobbyists.

4. **Public interest**

Upon election or appointment to office, parliamentarians shall/should arrange their private affairs so that foreseeable real or apparent conflicts of interest may be prevented from arising, but if a conflict does arise, it shall/should be resolved in a way that protects the public interest.

5. **Gifts and personal benefits**

Parliamentarians shall/should not accept any gift or personal benefit connected with their office that may reasonably be seen to compromise their personal judgment or integrity.

Appendix D

The United Kingdom's Seven Principles of Public Life

Selflessness

Holders of public office should take decisions solely in terms of the public interest. They should not do so in order to gain financial or other material benefits for themselves, their family or their friends.

Integrity

Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might influence them in the performance of their official duties.

Objectivity

In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.

Accountability

Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.

Openness

Holders of public office should be as open as possible about the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.

Honesty

Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.

Leadership

Holders of public office should promote and support these principles by leadership and example.

Appendix E

The United Kingdom's Civil Service Code

1. The constitutional and practical role of the Civil Service is, with integrity, honesty, impartiality and objectivity, to assist the duly constituted Government, of whatever political complexion, in formulating policies [of the Government], carrying out decisions [of the Government] and in administering public services for which [the Government] is responsible.

2. Civil servants are servants of the Crown. Constitutionally, [the Crown acts on the advice of Ministers] and, subject to the provisions of this Code, civil servants owe their loyalty to the [duly constituted Government].

3. This Code should be seen in the context of the duties and responsibilities [of Ministers set out in Questions of Procedure for Ministers], which include:

- accountability to Parliament;
- the duty to give Parliament and the public as full information as possible about [the] policies, decisions and actions [of the Government], and not to deceive or knowingly mislead [Parliament and the public];
- the duty not to use public resources for party political purposes, to uphold the political impartiality of the Civil Service, and not to ask civil servants to act in any way which would conflict with the Civil Service Code;
- the duty to give fair consideration and due weight to informed and impartial advice from civil servants, as well as to other considerations and advice, in reaching decisions; and
- the duty to comply with the law, including international law and treaty obligations, and to uphold the administration of justice;

together with the duty to familiarise themselves with the contents of this Code.

4. Civil servants should serve [the duly constituted Government] in accordance with the principles set out in this Code and recognising:

- the accountability of civil servants to the Minister or, as the case may be, the office holder in charge of their department;
- the duty of all public officers to discharge public functions reasonably and according to the law;
- the duty to comply with the law, including international law and treaty obligations, and to uphold the administration of justice; and
- ethical standards governing particular professions.

5. Civil servants should conduct themselves with integrity, impartiality and honesty. They should give honest and impartial advice to [Ministers], without fear or favour, and make all information relevant to a decision available to [Ministers]. They should not deceive or knowingly mislead Ministers, Parliament or the public.

6. Civil servants should endeavour to deal with the affairs of the public sympathetically, efficiently, promptly and without bias or maladministration.

7. Civil servants should endeavour to ensure the proper, effective and efficient use of public money.

8. Civil servants should not misuse their official position or information acquired in the course of their official duties to further their private interests or those of others. They should not receive benefits of any kind from a third party which might reasonably be seen to compromise their personal judgement or integrity.

9. Civil servants should conduct themselves in such a way as to deserve and retain the confidence of Ministers and to be able to establish the same relationship with those whom they may be required to serve in some future Administration. They should comply with restrictions on their political activities. The conduct of civil servants should be such that Ministers and potential future [Ministers] can be sure that confidence can be freely given, and that the Civil Service will conscientiously fulfil its duties and obligations to, and impartially assist, advise and carry out the policies of the duly constituted [Government].

10. Civil servants should not without authority disclose official information which has been communicated in confidence within the [Government], or received in confidence from others. Nothing in the Code should be taken as overriding existing statutory or common law obligations to keep confidential, or to disclose, certain information. They should not seek to frustrate or influence the policies, decisions or actions of the [Government] by the unauthorised, improper or premature disclosure outside the [Government] of any information to which they have had access as civil servants.

11. Where a civil servant believes he or she is being required to act in a way which:

- is illegal, improper, or unethical;
- is in breach of constitutional convention or a professional code;
- may involve possible maladministration; or
- is otherwise inconsistent with this Code;

he or she should report the matter in accordance with procedures laid down in [departmental] guidance or rules of conduct. A civil servant should also report to the appropriate authorities evidence of criminal or unlawful activity by others and may also report in accordance with [departmental] procedures if he or she becomes aware of other breaches of this Code or is required to act in a way which, for him or her, raises a fundamental issue of conscience.

12. Where a civil servant has reported a matter covered in paragraph 11 in accordance with procedures [laid down in departmental guidance or rules of conduct] and believes that the response does not represent a reasonable response to the grounds of his or her concern, he or she may report the matter in writing to the Civil Service Commissioners.

13. Civil servants should not seek to frustrate the policies, decisions or actions of the [Government] by declining to take, or abstaining from, action which flows from decisions by Ministers. Where a matter cannot be resolved by the procedures set out in paragraphs 11 and 12 above, on a basis which the civil servant concerned is able to accept, he or she should either carry out his or her instructions, or resign from the Civil Service. Civil servants should continue to observe their duties of confidentiality after they have left [their] employment.

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Auditor General of Canada
to the House of Commons

Chapter 13
Assessment of Financial Management Capabilities in Departments

October 2000

This October 2000 Report comprises 8 chapters as well as a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 13

Assessment of Financial Management Capabilities in Departments

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assessment of Financial Management Capabilities in Departments

Main Points

13.1 Our audit assessed the financial management capabilities in five government departments against the criteria established in the Financial Management Capability Model published in April 1999. We found that in each department gaps remain between current expectations for financial management and the existing capabilities of the departments. The capabilities needed to meet current expectations are consistent with those we have described in the Control Level of the Financial Management Capability Model.

13.2 We also noted that departments are at the initial stages of developing the capabilities needed to meet the requirements of the government's Financial Information Strategy and the Modernization of Comptrollership initiative. These capabilities are consistent with the capabilities described in the Information Level of the Financial Management Capability Model.

13.3 Based on the level of financial management capabilities in the departments that we audited, the challenges to be met in improving financial management are substantial. Only one department is close to meeting all the government's current expectations and none currently have the capabilities needed to meet the goals of the Financial Information Strategy and Modernization of Comptrollership initiative. Put simply, it will be very difficult to make government more businesslike if stronger financial information is not well integrated into both day-to-day management and accountability reporting to Parliament. The achievement of these capabilities throughout government will require the strong commitment and sustained support of the Treasury Board Secretariat, Privy Council Office and deputy ministers.

13.4 Our Office has expressed concern about the need to improve financial management in government for a number of years. Similarly, the Public Accounts Committee has noted, "There has been a common call for improvements in financial information to support government decision making." We have noted an increase in the number of initiatives being undertaken and a heightened sense of urgency to develop strong financial management capabilities. The government and the departments themselves have much to do in this area. The success of Results for Canadians — A Management Framework for the Government of Canada, the Financial Information Strategy and the Modernization of Comptrollership initiative will depend on this action.

Background and other observations

13.5 Financial management is an important component of what financial and program managers in departments and agencies do in delivering programs and services and exercising stewardship over the resources entrusted to them. An integrated and systematic approach to financial management allows managers to have the information to make sound decisions, manage risks well, and account properly for the use of public resources. Until recently, financial management has focussed on controlling budgets and processing transactions. Today's rapidly changing environment makes it urgent for the government to implement effective financial management.

13.6 We noted that departments had not implemented adequate monitoring of the effectiveness of their control frameworks. Such monitoring, together with providing assurance to senior management that control mechanisms are operating as designed, is an important component of sound management, particularly in a period of significant change that accompanies the implementation of new financial systems.

13.7 One of the most common gaps that we found in departments was the limited ability to combine or integrate financial and operational (non-financial) information. This gap has clear implications for individual departments and the government as a whole. First, if departments cannot integrate this information, they cannot give Parliament and the Canadian public a realistic picture of how much it has actually cost to produce a given result or deliver a given level of service. Second, without integrated information, senior management cannot readily forecast the downstream costs of major decisions — for example, a decision to increase or decrease the level of service of a program.

13.8 We also found that departments had not established a clear vision or strategy for the transformations that are to take place — an essential first step in managing the changes. Similarly, departments have not determined the skills and capacities that are needed to carry out these changes or whether there is a gap between what is needed and what they currently possess. We also noted that departments had not implemented specific measures against which progress in developing strong financial management capabilities can be tracked.

The response of the Treasury Board Secretariat, on behalf of the government and the five departments audited, is included at the end of this chapter. The response indicates that the recommendations are consistent with the current improvement plans and government expectations of sound management practices.

The responses of Canadian International Development Agency, Environment Canada, Fisheries and Oceans, Health Canada and Transport Canada are included in the case studies in the chapter. The responses indicate an intent to address the gaps identified and that in many cases initiatives are already under way.

Introduction

13.9 A long-standing strategic priority of the Office of the Auditor General of Canada has been to encourage better financial management in government and improve the role it can and should play. Accordingly, in 1997 the Office began a study of the current and future financial management requirements of federal government departments and agencies. The study's objective was to build a modern framework that would describe the key elements that departments and agencies need to institute effective financial management. The framework would also provide a basis for assessing the current state of the financial management capabilities of these organizations.

13.10 The result of the study, the Financial Management Capability Model (the Model), was published in April 1999. This document sets out the Office of the Auditor General's expectations for financial management and is the basis on which this audit and future audits in this area will be conducted.

13.11 Financial management is described in the Model as consisting of three elements: Risk management and control, information, and management of resources.

- **Risk management and control.** An organization must be able to identify the risks it faces (anything that could interfere with its ability to achieve its established objectives). It must also establish a framework for managing and controlling those risks. An important part of the control framework is the communication of the purpose, values and ethics of the organization.
- **Information.** The organization must have procedures to manage and protect the integrity of its data and to produce the type of information that managers need to conduct their business and account for how well they have discharged their responsibilities. The organization must also be able to deliver this information when it is needed. The information element includes the management of information systems and financial and operational (non-financial) performance information.
- **Management of resources.** This element of financial management focusses on enabling the organization to manage and direct its resources toward achieving its objectives economically and efficiently. Linkages to strategic planning, analysis and support for decisions are also included in this element.

13.12 Clearly, financial management does not exist in isolation. Rather, it works in concert with other important components of the organization's management. Indeed, these three elements of financial management overlap and relate to the other elements of management. Ultimately, good financial management is essential to good overall management.

A long-standing strategic priority of the Office of the Auditor General of Canada has been to encourage better financial management in government.

Objectives of financial management

13.13 All managers in government are entrusted with public resources, which they use to deliver programs and services. They have a responsibility to manage those resources with prudence and probity and due regard to economy, efficiency and effectiveness. They must also account for the way in which they have used the resources. Financial management is an important component of what financial and program managers in departments and agencies do in delivering programs and services and exercising stewardship over the resources entrusted to them. The essential objectives of financial management are summarized in Exhibit 13.1.

Financial management is an important component of delivering programs and services and exercising stewardship over resources.

Focus of the audit

13.14 The objective of this audit was to assess the financial management capabilities in selected departments

The Financial Management Capability Model identifies five progressive "capability levels" that represent well-defined stages toward developing a mature financial management regime.

against the criteria established in the Financial Management Capability Model.

13.15 The Model describes the essential elements of effective financial management. It sets out a path that an organization can follow to develop progressively more sophisticated financial management practices. It also shows the steps to be taken in progressing from a level of financial management typical of a start-up organization to the strong, effective, financial management capabilities associated with a mature and complex organization.

13.16 We have identified five progressive "capability levels" in the Model (see Exhibit 13.2). Each level represents a well-defined stage toward developing a mature financial management regime. The Control Level of the Model describes current expectations for financial management based on established Treasury Board guidelines, Receiver General directives and the *Financial Administration Act*. The Information Level generally describes the capabilities departments will need to achieve the goals of the government's Financial Information Strategy. The Managed and Optimizing Levels describe capabilities that will be needed to support the government's Modernization of Comptrollership initiative. The

Exhibit 13.1

Objectives of Financial Management

Provide support for decision making. Financial management provides managers with the information and knowledge they need to support operational decisions and to understand the financial implications of decisions before they are made. It also enables managers to monitor their decisions for any potential financial implications and for lessons to be learned from experience, and to adapt or react as needed.

Ensure the availability of timely, relevant and reliable financial and non-financial information. Financial management gives managers the information that either forms the basis for calculating financial information, or is used for management control and accountability purposes.

Manage risks. Financial management enables an organization to identify, assess and consider the financial consequences of events that could compromise its ability to achieve its goals and objectives and/or result in significant loss of resources. Financial management is an important component of risk management and needs to be considered with the full range of business risks, such as operationai and strategic risks as well as social, legal, political and environmental risks.

Use resources efficiently, effectively and economically. Financial management is necessary to ensure that an organization has enough resources to carry out its operations, and that it uses these resources with due regard to economy, efficiency and effectiveness.

Strengthen accountability. Financial management is essential for an organization to understand and demonstrate how it has used the financial resources entrusted to it and what it has accomplished with them.

Provide a supportive control environment. Financial management contributes to promoting an organizational climate that fosters the achievement of financial management objectives — a climate that includes commitment from senior management, shared values and ethics, communication and organizational learning.

Comply with authorities and safeguard assets. Financial management is essential to ensuring that an organization carries out its transactions in accordance with applicable legislation, regulations and executive orders; that spending limits are observed; and that transactions are authorized. It also provides an organization with a system of controls for assets, liabilities, revenues and expenditures. These controls help to protect against fraud, financial negligence, violation of financial rules or principles and losses of assets or public money.

Source: Office of the Auditor General of Canada Financial Management Capability Model — Application Guide, April 1999

The Financial Management Capability Model identifies five progressive "capability levels" that represent well-defined stages toward developing a mature financial management regime.

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Source: Office of the Auditor General of Canada Financial Management Capability Model — Application Guide, April 1999

sophistication of the capabilities may vary among organizations, depending on the nature, risk and complexities of the organizations.

13.17 Each capability level in the Model consists of a set of key process areas (see Exhibit 13.3). When an organization has met all of the key process areas associated with a given level of financial management capability, it may be considered to have achieved that level. Essentially, these key process areas are the building blocks that determine the financial management capability of an organization.

13.18 The five departments in which we conducted assessments were:

- Canadian International Development Agency
- Environment Canada
- Fisheries and Oceans
- Health Canada
- Transport Canada

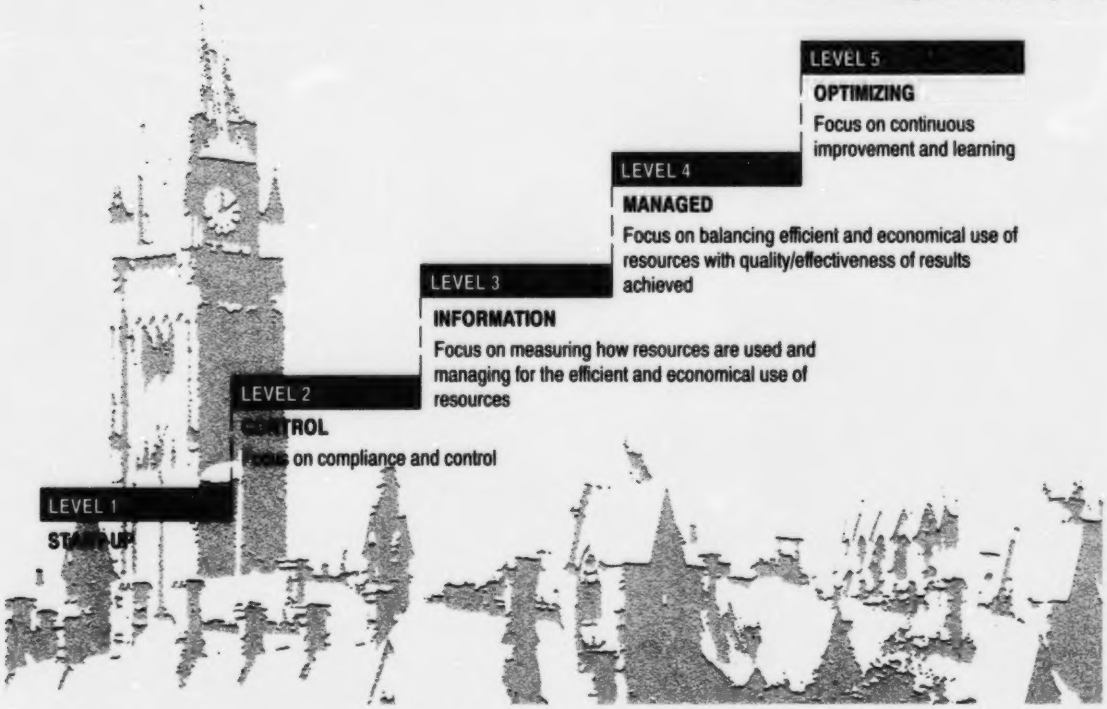
Case studies reporting on the results of our assessments are included at the end of the chapter.

13.19 As part of our work, we also reviewed the results of the comptrollership capacity checks carried out by the Treasury Board Secretariat in the following five departments:

- Agriculture and Agri-Food Canada
- Human Resources Development Canada
- Indian and Northern Affairs Canada
- National Defence
- Natural Resources Canada

Exhibit 13.2

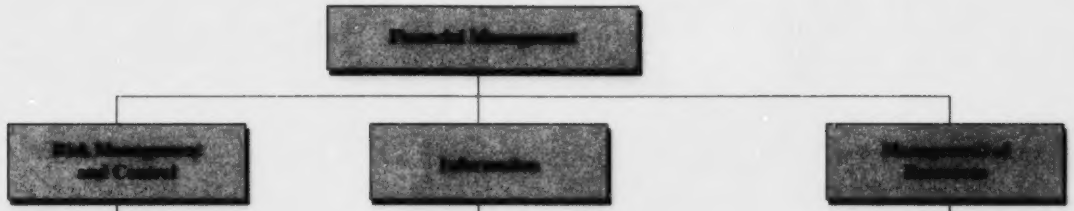
Financial Management Capability Model


LEVEL 5
OPTIMIZING
Focus on continuous improvement and learning
LEVEL 4
MANAGED
Focus on balancing efficient and economical use of resources with quality/effectiveness of results achieved
LEVEL 3
INFORMATION
Focus on measuring how resources are used and managing for the efficient and economical use of resources
LEVEL 2
CONTROL
Focus on compliance and control
LEVEL 1
START-UP

Source: Office of the Auditor General of Canada Financial Management Capability Model, April 1999

Exhibit 13.3

Key Process Areas Linked to Elements of Financial Management



ELEMENTS OF FINANCIAL MANAGEMENT	Organization Structure and Support	Risk Management and Control Framework	Information Systems Management	Financial and Non-financial Performance Information	Strategic Planning, Analysis and Decision Support	Results/ Quality Management	Resources and Process Management
KEY PROCESS AREAS							
Optimizing Level				• Prospective Information	• Strategic Improvement Targets	• Quality Improvement	• Optimizing Financial Management and Performance of Resources
Managed Level			• Information Management	• Organization Performance Information	• Enhanced Decision Support	• Quantitative Process Management	• Business Line Management
Information Level	• Financial Management Environment	• Risk Management	• Integrated Financial Management Systems	• Management Information and Reporting	• Performance Measurement	• Quality Measurement	• Cost Management • Resource Management
Control Level	• Organization Control Environment	• Internal Controls Management	• Data Management • General Accounting	• Stewardship Reporting	• Planning and Budgeting • Funding		• Operations Control

Source: Office of the Auditor General of Canada Financial Management Capability Model — Application Guide, April 1999

13.20 The capacity checks, part of the Modernization of Comptrollership initiative, were conducted as management self-assessments. Accordingly, the results reflect the views of departmental managers and are not the product of independent audit work. We have reviewed the results of the departmental managers' self-assessments, led by the Treasury Board Secretariat, to compare them with the results of our audit work. Further details on the audit are in **About the Audit** at the end of the chapter.

Observations and Recommendations

The Changing Expectations for Financial Management

13.21 In both the private and public sectors, stakeholders' expectations of financial officers, program managers and financial management are changing. For example, financial management specialists in the private sector are now expected to find ways to reduce the administrative costs of the organization and to offer strategic advice and analysis.

13.22 In the public sector, an ever-increasing need for stronger financial management capabilities has accompanied fundamental changes in government. These changes include:

- new ways of delivering services and programs: departments are entering into innovative arrangements with the private sector or other governments and often charging user fees. These new arrangements require departments to generate and integrate more sophisticated and complex financial and operational (non-financial) information to support decision making and to account for the results achieved;

- downsizing: despite reductions in supervisory, program and functional support (including finance and internal audit), it is still essential to maintain control over the organization's operations;

- movement from a command-and-control orientation: there is a move toward a new orientation where central standards allow more discretion over control processes and the operational approaches used;

- risk taking based on a risk management framework; and

- a shift from a government-wide centralized accounting system to departmental systems.

13.23 At the same time, parliamentary discussion of these issues is increasing. For example, the Standing Committee on Finance, in its report Challenge for Change — A Study of Cost Recovery, indicated an interest in knowing such things as how well user charges approximate efficient pricing and whether cost recovery has resulted in underfunding of cost recovery programs and overfunding of others. It also expressed an interest in performance standards to demonstrate how well cost recovery is operating.

Responding to the changes taking place in government will demand strong financial management capabilities.

13.24 Clearly, responding to these changes and issues will demand strong financial management capabilities in departments.

Government initiatives will require strong financial management capabilities

13.25 In its management framework, Results for Canadians, and through such initiatives as the Modernization of Comptrollership and Financial Information Strategy, the government has begun a number of efforts that are designed to improve both the management of the federal public service and the accountability of departments.

13.26 Results for Canadians — A Management Framework for the Government of Canada establishes an agenda for changes in the way that departments and agencies manage and deliver their programs and services. The framework includes four key commitments:

- a citizen focus on designing, delivering, evaluating and reporting on activities;
- a clear set of values to guide management in the public service;
- a focus on results and reporting them in a simple and understandable way; and
- a focus on linking the costs of initiatives with results to ensure responsible spending.

13.27 Of these, the commitment to responsible spending is of particular importance to this audit as it establishes a requirement for strong financial management capabilities.

13.28 The key expectations of these initiatives and the government's management framework are highlighted in Exhibit 13.4.

Benefits of Sound Financial Management

Effective financial management can benefit Parliament, departments and Canadians.

Effective financial management can benefit Parliament, departments and Canadians

13.29 Establishing effective financial management capabilities is not an end in itself. As noted earlier, a key objective of financial management is to strengthen accountability for how departments deliver their programs.

Exhibit 13.4

Key Expectations of Government

Results for Canadians – A Management Framework for the Government of Canada

The key expectations of the commitment to responsible spending are:

- **to produce information on program costs and results required for sound decision making to ensure responsible spending;**
- **to provide financial and non-financial performance information to link costs with actual or expected results;**
- **to provide, on a government-wide basis, integrated, cross-departmental information on expenditures and results; and**
- **to provide assurance that departmental management frameworks that support due diligence and stewardship of public resources are in place and working.**

Modernization of Comptrollership

The key expectations are:

- **to integrate financial and non-financial information;**
- **to identify and manage the risks of the organization; and**
- **to ensure that appropriate control systems are in place.**

Financial Information Strategy

The key expectations are:

- **to implement modern financial systems throughout government;**
- **to implement full accrual accounting and budgeting; and**
- **to enhance the government's decision making and to improve organizational performance through the strategic use of financial information.**

Sources: Treasury Board Secretariat, Results for Canadians – A Management Framework for the Government of Canada; The Modernization of Comptrollership in the Government of Canada; Financial Information Strategy departments and agencies manage and deliver their programs and services. The framework includes four key commitments:

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Results for Canadians – A Management Framework for the Government of Canada

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Modernization of Comptrollership

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The key expectations are:

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- to enhance the government's decision making and to improve organizational performance through the strategic use of financial information.

Sources: Treasury Board Secretariat, Results for Canadians – A Management Framework for the Government of Canada; The Modernization of Comptrollership in the Government of Canada; Financial Information Strategy

13.30 Effective financial management allows an organization to link financial information and performance information. By linking these two kinds of information, an organization can demonstrate what has been accomplished with the resources consumed or used. This is important information for all interested parties, including Parliament, the Canadian public and departments themselves. However, to produce this information, departments need to develop stronger and more sophisticated financial management capabilities than they now have. Some of the benefits of strong financial management capabilities are outlined in Exhibit 13.5.

Assessment of Financial Management Capabilities — Control Level

13.31 Organizations that have the capabilities associated with the Control Level of the Financial Management Capability Model are able to ensure that adequate resources are available, assets are safeguarded, data are reliable, and transactions are monitored and controlled and conducted with prudence and probity. Organizations at the Control Level are able to meet statutory and regulatory reporting requirements.

13.32 As well, organizations that have institutionalized the key process areas for this level will have established a control framework, and mechanisms to ensure that control practices are repeatable and sustainable. When these basic controls are operating as intended, they will help the organization to control or reduce risks and to produce complete and accurate financial and operational data.

13.33 The Control Level of the Model describes an organization that has complete, timely and accurate financial and operational data, and that can carry out its basic stewardship responsibilities and meet its reporting obligations. The capabilities described in the Control Level link directly to Treasury Board policies and guidelines.

13.34 To reflect the capabilities of the Control Level, an organization must have mastered the eight key process areas associated with that level. It is important to recognize the interdependencies among the various key process areas in establishing effective financial management capabilities.

Departments need to monitor their control systems more closely

13.35 Internal control systems are essential to managing an organization. Even at the most basic level, they need to provide management with reasonable assurance that:

- transactions are recorded completely and accurately and on a timely basis;

Capabilities at the Control Level ensure that adequate resources are available, assets are safeguarded, data are reliable, transactions are processed accurately, and organizations are able to meet statutory reporting requirements.

Exhibit 13.5

Benefits of Strong Financial Management Capabilities

Stakeholders	Desired Outcomes of Strong Financial Management Practices
Canadians	• Information on costs of services received is available. • There is improved information for the scrutiny of government spending.
Parliament	• There are informed decisions about allocation of resources to meet government policy objectives.
Departments	• Information is available on resources required to manage operations and deliver programs at reasonable cost that meet the needs of Canadians. • Decisions are made with relevant, understandable and reliable information. • Information is available for accountability to key stakeholders.

- assets are safeguarded and protected from fraud and losses of all kinds; and

- resources are received and used in accordance with applicable laws and regulations.

13.36 An element of the Financial Management Capability Model — and indeed of sound management practices — is the expectation that management will have established systematic mechanisms for monitoring and reporting on the effectiveness of its system of internal controls.

13.37 Monitoring provides relevant information to management and supports the department's annual letter of representation on the adequacy of its internal controls. A department submits this letter to the Receiver General as part of preparing its annual public accounts statements.

Departments had limited capabilities for monitoring and reporting on the effectiveness of their departmental control systems.

13.38 We found that the departments included in our audit had limited capabilities for monitoring and reporting on the effectiveness of their departmental control systems. Similarly, departments could not demonstrate the work that they had done to support their annual representation on having maintained an adequate and effective system of controls throughout the period. Departments incur unnecessary risks by not adequately monitoring and reporting on the effectiveness of their departmental control framework. These risks increase as departments decentralize the operation of their financial systems to program managers. We also noted that the internal audit function needs to broaden and strengthen its capacity to provide assurance on departmental control frameworks.

13.39 Departments should strengthen their capabilities for monitoring and reporting on the effectiveness of departmental control systems.

The accuracy and timeliness of financial data are of concern

13.40 Of paramount importance for any financial system is that managers view the financial data that the system produces as relevant, reliable and timely.

13.41 Each of the departments included in our audit has implemented, or is in the process of implementing, a new departmental financial system. These systems were designed to enable departments to deal with Year 2000 issues and to meet the objectives of the government's Financial Information Strategy.

13.42 In the departments included in our audit, program managers expressed concerns about the timeliness and accuracy of the financial data from the department-wide systems. To compensate, many managers maintain separate or supplementary books and records (commonly referred to as "black books"). A major impact of maintaining and using supplementary systems is the cost associated with the time and effort required to design, implement and maintain them. Although we did not try to estimate the cost of maintaining supplementary systems, considerable resources are being used.

13.43 The implementation of the new department-wide systems has introduced extensive change within departments. Departments have decentralized the operation of their department-wide systems to program managers in the various departmental business lines, who are now responsible for recording departmental transactions. More effort will be needed to ensure that all managers clearly understand how the systems operate and what their responsibilities are for assuring the completeness and accuracy of financial and operational (non-financial) data.

13.44 Departments should provide additional training and support to

managers and staff on the operation of the departmental financial systems.

13.45 Departments should strengthen their capabilities for monitoring the accuracy and timeliness of financial data and the effective linkage to operational data.

Assessment of Financial Management Capabilities — Information Level

13.46 The capabilities at the Information Level (Level 3) of the Financial Management Capability Model are essential to many of the current initiatives of the federal government. They focus on the integration of the organization's financial and operational systems, and on the practices and procedures necessary to provide information that can be used to manage resources efficiently, economically and with prudence and probity.

13.47 An organization at the Information Level will be able to both measure and manage its risks. As well, it can tailor management practices within its various operating units to manage and reduce its risks in a cost-effective manner. The organization can also generate information on the cost of producing a product of a given quality or delivering a service at a given level.

13.48 A key aspect of the Information Level is the changing role of the finance function. The role has begun to move away from performing only the traditional accounting functions to performing as a team player and providing support to operational managers. Finance staff work with operational managers to develop a financial structure that provides them with cost-effective controls and information that meets their day-to-day needs (for example, information on the cost of departmental programs).

13.49 Critical to achieving this level of capability is a climate that institutionalizes financial management practices throughout the organization. This requires senior management to explicitly demand and promote effective financial management and demonstrate its value to the organization and to the government as a whole. Such a culture is developed by formalizing financial management policies and practices across the organization and supplementing them with appropriate training and a system of rewards, recognition and sanctions that reinforces the culture.

13.50 To demonstrate the capabilities of the Information Level, an organization must have mastered the eight key process areas associated with that level. We found that departments we examined have initiatives under way to develop Information Level capabilities. To support these efforts, departments must strengthen and maintain the capabilities of the Control Level in order to provide a strong foundation upon which more advanced capabilities may be established.

Capabilities associated with the Information Level ensure that risks are managed, financial and non-financial systems are integrated, and resources are managed efficiently, effectively and economically.

A vision and strategy for financial management are needed within departments

13.51 A first step toward dealing with the capability gaps in departments is to develop a clear vision of how financial management should integrate with an organization's management practices, and how financial management should support the organization. Given the nature and extent of changes taking place within government and the critical importance of financial management, we looked to see if departments had established such a vision, together with a clear strategy for instituting effective financial management. Such a strategy and vision provide an important vehicle for communicating the changes that the organization is trying to implement.

Departments have initiatives under way to develop Information Level capabilities.

13.52 We found that while some elements of such a vision and strategy are in place, others are missing. For example, although departmental financial information strategies address issues related to new systems and accrual accounting, they do not clearly address issues related to the third component of the Financial Information Strategy that deals with the integration of financial and operational information. In our view, this is an important element that needs to be addressed if substantive progress is to be made in developing strong financial management capabilities.

While some elements of a vision and strategy are in place, others are missing.

13.53 An important part of such a vision and strategy is the clear articulation by departments of the capabilities that they require and the levels of sophistication they wish to establish for these capabilities.

13.54 As a first step in dealing with gaps in financial management capabilities, departments should have a clear vision of how financial management is intended to support the organization's management practices, together with a strategy for achieving the vision. Departments, in conjunction with Treasury Board Secretariat, should determine the capabilities and levels of sophistication needed.

Competencies and skills needed for the future are yet to be determined

Departments have to determine the competencies and skills they need for the future.

13.55 Another important prerequisite for establishing effective financial management practices in departments is to ensure that staff have the appropriate knowledge, ability and skills needed to carry out their responsibilities.

13.56 The criteria set out in the Model include an expectation that departments audited would have identified the capabilities and skill sets needed to successfully implement the government's initiatives, assessed their current capabilities, and developed a strategy for closing any gap between the two. However, we found that although managers had indicated a need for their departments to improve and strengthen the financial management skills of staff, only two departments had identified the core competencies required to meet their current and future human resource needs. We noted that none of the departments had assessed their current financial management competencies or developed a strategy for obtaining or developing the skill sets required to achieve an appropriate level of financial management capability.

13.57 Departments also need to be able to attract and retain competent financial management staff. In each of the departments included in our audit, financial managers commented on the difficulties that they have experienced in this area. Managers noted high turnover rates of approximately 30 percent and a difficulty in staffing vacant positions. Although the departments were able to provide anecdotal reasons for these difficulties, none had analyzed in a systematic manner why they were occurring. Departments will have to do this analysis as a first step toward identifying the underlying causes of these staffing problems. We have reported similar concerns in 1999, Chapter 21, Financial Information Strategy: Departmental Readiness.

13.58 We also noted that, through the FORD program of the Treasury Board Secretariat, departments have been able to recruit recent university graduates into the financial community of the federal government. While departments expressed satisfaction with the recruits obtained through this program, they have concerns about their inability to retain the recruits over the long term. Departments have not systematically tracked the reasons for the high rate of turnover.

13.59 Departments and the Treasury Board Secretariat should develop strategies and plans to ensure that the government can attract and retain financial staff with the appropriate skills, knowledge and experience needed to carry out their responsibilities.

Departments should assess their current capabilities and develop a strategy for closing any gaps between the capabilities required and those they presently have.

Financial and non-financial systems need to be integrated

13.60 One of the key capabilities of the Information Level of the Financial Management Capability Model is the ability to support the management of an organization's resources through the use of financial and operational (non-financial) information in strategic planning, analysis and decision making. As part of our audit, we assessed the progress being made by departments toward achieving this capability.

13.61 One of the key attributes of an organization at the Information Level is its ability to provide consistent and comparable financial information, with appropriate linkages to operational information, that meets the needs of managers. This information provides a basis for developing performance indicators and cost and quality measures. It can also be used to support and demonstrate the extent to which the organization has used its resources effectively.

13.62 As noted earlier, each of the departments included in our audit has installed a new financial system, some quite recently. We noted that while these systems have the potential to allow departments to develop integrated information, progress to date has been limited. We also noted that the departments have in place various systems that capture similar types of information and, in some instances, that cannot communicate with each other.

13.63 The need to integrate financial and operational information is a long-standing concern in government. Although the departments included in our audit have implemented new financial systems, they have indicated that they have only just begun the task of integrating financial and operational information.

13.64 Departments should ensure that systems integration plans meet the third objective of the government's Financial Information Strategy, the integration of improved financial information into day-to-day decision making by departmental managers.

Departments have only just begun the task of integrating financial and operational information.

Performance measures to assess the effectiveness of the finance function need to be strengthened

13.65 As noted earlier in the chapter, the finance function within government is going through considerable change. Many government initiatives that depend upon strong financial management capabilities for their success are presenting significant challenges to the finance function as it tries to implement these initiatives.

13.66 One component of managing the change is a clear vision of the transformations that are to take place. Such a vision, along with a strategy for realizing it, needs to be accompanied by performance measures for the finance function. These performance measures should:

- clarify, communicate, and focus on the strategic objectives;
- serve as a basis for making continuous improvements; and
- indicate whether the strategies have resulted in improved performance and the realization of the vision.

13.67 As part of our audit, we reviewed the performance measures that the finance groups had established for themselves. In general, we found that these measures focussed on the transactional level — for example, the number of days required to issue a cheque. Although such relatively low-level indicators reflect an important element of what the finance function does within an organization, they do not provide a measure of how well the finance group is doing in supporting the changes required by such government initiatives as the Financial Information Strategy and the Modernization of Comptrollership. Such measures might include, for example, the relative use of finance resources for transaction processing compared with business support, or the level of understanding by program managers of their financial management responsibilities.

13.68 We also reviewed the performance agreements established for the senior financial officer and the senior full-time financial officer in the departments included in our audit. We noted that these agreements followed the structure established by the Treasury Board Secretariat, and that all included ongoing and key commitments. The Treasury Board Secretariat requires that each commitment have one or more performance indicators. Some of the commitments we reviewed lacked the necessary performance indicators. Most of the commitments and the related performance indicators in the agreements we reviewed were vague. They did not, in our opinion, lend themselves to measuring performance in a quantifiable way, as required by Treasury Board guidelines.

13.69 Departments should ensure that effective performance measurement indicators are established to accompany the vision and strategy for financial management that will support the organization's management practices.

13.70 Performance agreements for senior financial officers and senior full-time financial officers should include specific, measurable commitments to guide the finance group and the department in assessing progress on the changes required by the government's Financial Information Strategy and the Modernization of Comptrollership initiative.

Results of the Treasury Board Secretariat's Work

13.71 As part of its Modernization of Comptrollership initiative, the Treasury Board Secretariat carried out comptrollership capacity checks in five departments. The objective of the checks was to provide the Secretariat and the departments with a baseline assessment of existing comptrollership capacities. These assessments provide a point of reference from which departments can develop action plans to enhance their comptrollership capabilities. They also provide a baseline against which future progress can be measured.

13.72 Although the Treasury Board Secretariat used a different approach from that of the Office of the Auditor General in carrying out its work, there is a strong correlation in the scope of the two methodologies. A key distinction between the two is the self-assessment approach of the comptrollership capacity checks.

13.73 We noted some common findings related to the basic capabilities of the Control Level. These include accounting practices that generally comply with government requirements and a need for increased monitoring of departmental control systems.

13.74 We also noted some areas of difference. For example, while our audit indicated program managers' concerns about the completeness, timeliness and accuracy of financial data, the departments included in the capacity check self-assessments indicated that financial data were accessible, timely and accurate.

13.75 We noted a strong correlation between the two approaches in the observations related to the Information Level capabilities. These include the following:

- Departments need to define the competencies required of managers, assess current competencies, and develop a strategy to close any gaps.
- Departments are at the initial stages of developing such capabilities as risk management.
- There is limited integration between financial and operational systems.
- Cost management practices are not formalized.
- Departments are at various stages of evolution in developing corporate performance measures.

13.76 These assessments are an important first step in strengthening financial management capabilities. They provide a basis from which departments are expected to develop improvement strategies; they also provide a baseline against which future progress may be measured and reported. Such reporting could be in their annual Report on Plans and Priorities or Departmental Performance Report.

13.77 The Treasury Board Secretariat should ensure that departmental action plans prepared in response to the results of its assessments establish specific deliverables and time frames against which it can monitor the progress of departments in closing the identified gaps.

13.78 The Treasury Board Secretariat should report on its plans and progress in strengthening financial management capabilities.

Key Challenges for Sustained Progress

13.79 In its Nineteenth Report to the House (1998), the Public Accounts Committee noted that on many occasions "there has been a common call for improvements in financial information to support government decision making." While our current audit noted a number of positive initiatives and an increased sense of urgency, much remains to be done. If the initiatives are to be successful and result in strong financial management capabilities, there are a number of key challenges that need to be addressed. These challenges, which are described in greater detail below, include:

- sustaining initiatives over time;
- developing strategies to implement effective financial management;
- implementing a changing role for finance;
- increasing the consistency of departmental practices;
- providing stronger assurance on departmental control frameworks;
- increasing confidence in departmental information systems;
- linking financial and operational planning; and
- supporting performance measures.

13.80 Sustaining initiatives over time. In the past, and indeed today, many of the important government-wide initiatives have been led by the Treasury Board Secretariat. While this leadership is important, it is not enough. As the Office has previously reported, similar initiatives have been undertaken in other jurisdictions. A common thread in their success was strong political demand for the change in management philosophy, together with monitoring of progress achieved. The strong commitment and sustained support of the Treasury Board Secretariat, Privy Council Office and deputy ministers, as well as ministers and Parliament will be needed to advance financial management capabilities within government.

13.81 Managing the types of challenges noted above and meeting the objectives of the government's management framework and recent management initiatives will require significant cultural changes within government. Such changes include, among others, the need to integrate financial information into decision making, the need to implement and use accrual accounting and accrual appropriations, and the need to better understand the role that financial management can and should play in the organization. These changes will not occur quickly; in the absence of clear plans and strategies for change management, as well as sustained pressure, they may not occur at all.

The needed changes will not occur quickly; in the absence of clear plans and strategies for change management, as well as sustained pressure, they may not occur at all.

13.82 The departments included in our audit have undertaken a number of actions in support of the government's initiatives that are designed to improve their financial management capabilities. A key challenge for them will be to maintain the momentum behind these actions and to ensure that they are fully and effectively implemented.

13.83 Departments need a climate that supports and encourages good financial management practices. Given the significant changes taking place in government and within departments, this will be a particular challenge.

An integrated strategy is needed to provide clear direction and co-ordination for departmental initiatives.

13.84 Developing a strategy to implement effective financial management. We noted that many initiatives that support effective financial management are currently under way in departments. However, in many instances these initiatives are being approached on an individual basis, without a clear articulation of the linkages among them. A corporate strategy is needed to provide clear direction and co-ordination for these initiatives.

13.85 In developing such strategies, departments need to ensure that they have the human resource capabilities needed to make the change effort successful and to deliver their programs effectively. This is of particular concern, given the demographics of the financial community and the difficulties the government is experiencing in attracting and retaining financial specialists.

13.86 Departmental strategies need better linkages both within and between levels, as capabilities in one level provide a foundation for those in the next level. Linkages within levels are critical for the development of the capabilities needed to support the management and delivery of departmental programs.

13.87 Establishing a changing role for finance. Clearly, the finance function within departments needs to play an active leadership role and move beyond the traditional role of functional support. This requires a proactive approach to working with program managers to ensure that they are provided with appropriate analysis and decision-making support.

13.88 Implementing consistent practices. Our audit noted that in most departments, a range of financial management practices exists across departmental business lines. For example, there are different approaches to developing plans and budgets and classifying basic data. The use of different practices makes it difficult to aggregate information on a departmental basis and meet the information needs of departmental managers. Corporate systems and practices need to ensure a consistent approach to financial management.

13.89 Providing assurance on departmental control frameworks. At the Control Level, departments need strong mechanisms for providing assurance to senior management and central agencies that the departmental control framework is working as intended.

13.90 Increasing confidence in departmental information systems. In most of the departments included in our audit, we found that many program managers expressed a lack of confidence in departmental information systems. This was due to several factors, including concerns over the accuracy or timeliness of financial data and the inability of systems to provide information in a format that was useful to them. Increased confidence in departmental information systems is necessary to eliminate the inefficiencies created when managers maintain their own records and books of account.

13.91 Linking financial and operational planning, monitoring and reporting. Most financial and operational systems and processes are typically independent and rarely linked. Planning for financial resources is often independent of planning for operational results. Similarly, information systems track financial information independently of information on results.

13.92 Departmental information has to meet the various requirements of corporate, business line, regional and operational managers in addition to serving the accountability requirements of Parliament and Canadians.

13.93 Supporting performance measurement with rewards and recognition. Essential to any transformation are performance measures that allow an organization to measure and report on the progress being made and to determine whether the desired changes in behaviour are occurring. Our audit noted that the departments had not yet developed such performance measures for tracking the transformation of the finance function in responding to the challenges of the Financial Information Strategy and the Modernization of Comptrollership initiative. Equally important is the need to reinforce the desired changes and link them to the achievement of established objectives.

Conclusion

13.94 The government has a number of important initiatives under way that are designed to improve the management of the federal public service. Essential to many of these initiatives is the need for strong, effective financial management.

13.95 Our audit noted gaps in some of the basic financial management capabilities that are required to meet the government's current expectations. These gaps need to be addressed so that departments can develop the more advanced capabilities needed to support the requirements and goals of the key government initiatives.

13.96 Although departments and central agencies have begun the process of developing the capabilities necessary to support the government's Financial Information Strategy and the Modernization of Comptrollership initiative, significant challenges remain. We believe that with sustained effort, departments can develop the necessary capabilities.

13.97 The most significant challenge will be to institutionalize in departments a strong appreciation of the role that financial management can and should play in day-to-day decision making. Such a cultural change will require the strong commitment and sustained support of the Treasury Board Secretariat, Privy Council Office and deputy ministers to develop and maintain departmental financial management capabilities.

The strong commitment and sustained support of the Treasury Board Secretariat, Privy Council Office and deputy ministers are needed to develop and maintain departmental financial management capabilities.

Treasury Board Secretariat's response: *The Government of Canada has placed a high priority on the modernization of comptrollership, including the strengthening of financial management capabilities in departments and agencies. This is one of the six priorities set out in Results for Canadians —A Management Framework for the Government of Canada. The Modernization of Comptrollership initiative builds on a number of activities under way across government and is led by the Treasury Board Secretariat and a group of pilot departments.*

There are a number of common findings between the Office of the Auditor General's review of financial management capabilities in the five departments it examined and the results of comptrollership assessments completed by the Treasury Board Secretariat and the first group of pilot departments. There are also some differences, as noted in this chapter. Overall, the Auditor General's recommendations are consistent with the current improvement plans and expectations that have been established for sound management practices in the government's management framework.

We are confident that the government has good systems of financial controls and that these controls are generally working; however, we agree with the Auditor General that certain improvements are necessary. The Treasury Board Secretariat is actively pursuing these improvements. For example, steps are being taken to continue the implementation of the Financial Information Strategy, to strengthen the internal audit and evaluation functions across government, and to redefine the approach to central monitoring of departmental activities. These enhancements to internal controls are being implemented in a balanced way to support delegation of authority and encourage innovation at the front line while reinforcing appropriate accountability.

The government's overall strategy for implementation of the Modernization of Comptrollership initiative will build on the findings of the Auditor General's work and the capacity assessments done in pilot departments. Priorities for improvements have been established in these departments and implementation will be monitored to ensure that the expected results are achieved.

About the Audit

Objective

The objective of this audit was to assess the financial management capabilities in selected departments.

Scope

The five departments in which we conducted assessments were:

- Canadian International Development Agency
- Environment Canada
- Fisheries and Oceans
- Health Canada
- Transport Canada

As part of our audit, we also reviewed the results of the comptrollership capacity checks undertaken by the Treasury Board Secretariat in the five pilot departments. These were:

- Agriculture and Agri-Food Canada
- Human Resources Development Canada
- Indian and Northern Affairs Canada
- National Defence
- Natural Resources Canada

Criteria

The criteria used during the audit are from the Financial Management Capability Model published by the Office in April 1999.

The Model is a framework for strengthening financial management through many small evolutionary steps. It illustrates the stages through which an organization can evolve as it defines, implements, measures, controls and improves its financial management processes.

The detailed criteria are set out in the key process areas in the five levels of the Model. The five levels are the following:

- The Start-Up Level describes the financial management capabilities of a start-up organization that has not yet established its key policies and practices.

- **The Control Level focusses on establishing the controls needed to safeguard assets and to ensure that data are reliable and operations are monitored and controlled. This level generally describes the capabilities that are needed to meet current financial management requirements.**
- **The Information Level focusses on integrating an organization's financial and operational (non-financial) systems, practices and procedures to provide information that can be used to manage resources in an efficient and economical manner. This level reflects the capabilities that will be needed to meet the requirements of the government's Financial Information Strategy.**
- **The Managed Level focusses on using information to balance the competing objectives of using resources efficiently and economically and achieving high-quality and effective results.**
- **The Optimizing Level focusses on continuous improvement and learning.**

The focus of our audit work was on determining the extent to which departments met the requirements of the Control and Information levels. These are the capabilities that are consistent with the requirements of the government's Financial Information Strategy and Modernization of Comptrollership initiative.

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Canadian International Development Agency

Background

The Canadian International Development Agency (CIDA) is responsible for supporting sustainable development in developing countries. The Agency's six program priorities focus on developing basic human needs, women in development, infrastructure services, human rights, democracy and good governance, private sector development and the environment.

CIDA's budget in 1999-2000 was $1.8 billion. Expenditures are made in the form of grants, contributions and other transfer payments. These payments are made to Canadian and developing country institutions, provincial governments and their organizations and agencies, non-governmental organizations, and Canadian private sector firms, for specific development projects, programs and activities.

CIDA operates in a complex and changing environment where its priorities are affected by unforeseen environmental events and the complexity of projects being delivered in underdeveloped countries. CIDA also operates in an environment where changing foreign policy directions and emergency situations require actions to be taken quickly.

Over the past year, CIDA has undergone a significant number of changes. These include numerous organizational changes, new senior management appointments, and the implementation of new enterprise-wide systems. Each of these changes affects how CIDA does its business. In such a changing environment, it is essential that CIDA have the capabilities that support sound financial management practices.

Scope of our work

We focussed our work on the Human Resources and Corporate Services Branch, the Policy Branch, the Africa and the Middle East Branch of the Bilateral Program, the Asia Branch of the Bilateral Program, the Multilateral Programs Branch, and the Performance Review Branch. Our work was carried out at CIDA headquarters.

Summary assessment

CIDA has substantially met the requirements of four of the eight key process areas of the Control Level of the Financial Management Capability Model. While the Agency has established many of the basic financial management capabilities, we found that there remains a gap between current expectations for financial management and the Agency's existing capabilities. We noted that the capabilities related to internal controls management, data management, planning and budgeting, and operations control need to be strengthened.

We also noted that the Agency has a number of initiatives that are designed to develop the capabilities of the Information Level of the Model. These capabilities are generally those that departments will need in order to meet all of the objectives of the government's Financial Information Strategy and Modernization of Comptrollership initiative.

Listed below are certain strengths that we noted during our audit. We have also described specific weaknesses related to the Control Level.

Strengths

Organization control environment. CIDA has clearly defined its mission and vision, and staff have a strong commitment and understanding of the Agency's mandate and their role in the achievement of its mission. CIDA encourages consultation and has used surveys and other mechanisms for several years to obtain feedback from its employees and key stakeholders.

Integrated financial management systems. CIDA is developing an integrated enterprise-wide system that is designed to reduce the number of systems and provide users with both financial and non-financial information. The Agency recently implemented several modules in its enterprise-wide system for financial, project, material and results-based management. Following the initial implementation of a new financial system on 1 June 1999, CIDA reacted quickly to identify and correct data integrity problems. This enabled the Agency to have reliable financial information to monitor year-end budgets.

Performance measurement. CIDA has implemented a results-based management system to collect results information primarily for reporting purposes. Senior management has demonstrated commitment to results-based management by developing policy, frameworks and tools, and by providing training and assigning staff to support operational managers at both the corporate and branch levels. Recently, the Agency released a tailored, results-based management module within its new enterprise-wide system to collect and track results information systematically across the Agency.

Weaknesses

Internal controls management. Although CIDA has numerous control mechanisms, there is no documented corporate internal control framework. There is limited ongoing monitoring to ensure that controls are effective and operating as designed. No performance measures are in place to monitor the effectiveness of the internal control framework, and limited independent review is conducted to ensure that controls meet the Agency's needs. Internal audit needs to strengthen its capacity to provide assurance on the adequacy of agency control systems.

Data management. Although considerable effort was dedicated to the data reconciliation and clean-up exercise, there is a lack of processes to regularly monitor data integrity and ensure that it is maintained. Users find the new financial system cumbersome to use and difficult to obtain information from. While key control mechanisms for data management have not been fully developed, the responsibility for data management has been assigned to the newly created position of Chief Informatics Officer. Without the ability to provide high-quality data on a continuous basis, information generated for reporting and decision-making purposes will not be reliable or useful.

Canadian International Development Agency (continued)

Planning and budgeting. We found that managers spend considerable time developing various plans throughout the year. CIDA has many planning processes for resource allocation and business planning that are independent. For example, development of branch strategic plans is independent of the resource allocation process. We found that none of these individual planning processes have been documented; nor has CIDA developed a corporate planning framework to provide a holistic view of how the various planning processes fit together. Branches have varied approaches to developing plans, and the content is considerably different. We also noted that CIDA has not been able to produce a corporate strategic plan that communicates its corporate performance targets to staff.

Operations control. We found that CIDA manages its financial budgets, but they are monitored in isolation of operational results. For instance, the project performance review process is not linked with the mid-year resource reallocation process. This weakens CIDA's ability to analyze variances and their implications. Since the implementation of its new financial system, managers and finance do not have key monitoring reports, such as account aging reports and financial status reports to enable appropriate monitoring of resources. Manual records have been maintained to supplement this requirement. A process for monitoring and managing internal operations needs to be developed to ensure consistent and efficient practices in the event that key individuals leave.

Department's response: *The Canadian International Development Agency (CIDA) is enhancing its financial management framework to better respond to the government's Modernization of Comptrollership initiative and Financial Information Strategy. The actions undertaken to date firmly demonstrate our commitment to achieving the stated objectives. Action plans are being developed to address the areas in need of improvement.*

Environment Canada

Background

Environment Canada is responsible for the preservation and quality of the natural environment and renewable resources (including water, migratory birds and other non-domestic flora and fauna); carrying out meteorological services; enforcement of the rules of the Canada-U.S. International Joint Commission; and co-ordination of federal environmental policies and programs.

The Department had a budget of approximately $548 million for 1999-2000, distributed over its four business lines: Clean Environment, Nature, Meteorological Service of Canada, and Management, Administration and Policy.

Environment Canada has undergone significant changes in recent years. While the Department's basic mandate has not changed since it was established in 1971, the range and nature of the issues and challenges it faces have evolved considerably.

Scope of our work

We concentrated our efforts on the Meteorological Service of Canada and the Clean Environment business lines, and the Corporate Services Branch from the Management, Administration and Policy business line. Our audit included the departmental headquarters and the National Capital, Pacific and Yukon, and Ontario regions.

Summary assessment

Environment Canada has substantially met the requirements of four of the eight key process areas of the Control Level of the Financial Management Capability Model. While the Department has established some of the basic financial management capabilities, we found that a gap remains between current expectations for financial management and the Department's existing capabilities. We noted that capabilities related to internal controls management, data management, planning and budgeting, and operations control need to be strengthened.

We also noted that the Department is at the initial stages of developing the capabilities of the Information Level. These capabilities are generally those that departments will need to meet all of the objectives of the government's Financial Information Strategy and Modernization of Comptrollership initiative.

Listed below are certain strengths that we noted during our audit. We have also described specific weaknesses related to the Control Level.

Strengths

Organization control environment. Environment Canada has developed and published its Management Framework, which describes its vision, mission, responsibilities, accountabilities and the results expected from its four business lines.

Quality measurement. In critical operational areas, the Department has quality measurement processes that are mature and of a high standard. For example, at the Canadian Meteorological Centre the quality of the forecasting system is measured routinely and compared with that of other international weather centres.

Weaknesses

Internal controls management. Important components of internal control are in place but the Department does not have an overall internal control framework, an important vehicle for communicating managers' responsibilities for internal control. In addition, there is no clearly established process for monitoring internal controls, and few performance measures are in place to monitor the effectiveness of internal controls. Formal processes are required to support the assurance on the operation of controls provided by senior managers in their letters of representation. We also noted that the Department does not comply with Treasury Board policies on asset management: the data capture of new assets is not up-to-date, and inventories are not performed to confirm asset records. Internal audit needs to strengthen its capacity to provide assurance on the adequacy of the departmental control systems.

Data management. Although Environment Canada has some of the elements of data management, it has not effectively implemented its data management policy and no corporate mandate has been assigned to ensure the integrity of corporate data. The Department has a defined structure for financial data. Managers consider financial information to be accurate but not timely or easily accessible. In addition, managers claim that information from the asset system does not serve their needs. In many instances, program managers have developed their own local systems to track their operational information without corporate guidance on systems development practices. A corporate approach to data management for both financial and non-financial data will be required to establish a common systems architecture in the Department.

Planning and budgeting. Environment Canada has some of the elements needed for this key process area. While the Management Framework used by the Department provides a business-line structure that supports the planning and budgeting process, Environment Canada has not fully documented how the various financial and operational planning processes are integrated. The Department has not developed standardized corporate tools to support consistent workplanning, and managers do not use the same terminology in their preparation. In addition, managers are not consistently required to establish even basic output measures of expected performance unless the unit is in its start-up phase. Corporate systems need to be developed or improved to provide greater consistency to the planning process and a mechanism for the aggregation of information on all activities.

Environment Canada has not prepared a Long-Term Capital Plan since 1990, although one is required by the Treasury Board every five years. To compound this problem, asset records are not up-to-date and inventories of these assets have not been performed, as required by Treasury Board regulations. As part of Program Review, and to meet other requirements to reduce expenditures, the Department chose to reduce its capital budget from $80 million to $24 million. Environment Canada recognizes that it faces a significant rust-out problem, and managers believe that they do not have sufficient funds to replace deteriorating assets on a life-cycle basis.

Environment Canada (continued)

Operations control. We noted that the Department exercises strong commitment control. A primary concern, however, is that managers do not have the information, relating financial and non-financial measures, that they need to make decisions. To compensate for weaknesses in corporate financial systems, individual managers have developed their own workplanning and monitoring processes and often keep a duplicate system to track operations and expenditures. Problems arise in the aggregation of information from these unique systems, resulting in a gap in management information and a risk that the Department may not make optimum use of its resources. Mid-level managers expressed concern that appropriate information is not available to them.

Department's response: *Environment Canada is moving forward with the implementation of its Modern Management Agenda, which addresses issues of capacity building and renewal of the financial management functions in the Department. A detailed implementation plan is being prepared and will be presented to Environment Canada senior management in fall 2000. In addition, substantial progress has been made in the last few years with the implementation of a new financial system, the establishment of a detailed implementation plan for the Financial Information Strategy, and the development of a Management Information Blueprint. These initiatives will support improvements in performance information, risk management and strengthened control systems as well as lay the foundations to enable the Department to systematically capture and use financial, human resources and performance information at the corporate and business line levels.*

Fisheries and Oceans

Background

Fisheries and Oceans is responsible for developing policies and programs in support of Canada's economic, ecological and scientific interests in oceans and freshwater fish habitat; conserving Canada's fisheries resources in marine and inland waters and promoting their sustainable use; and providing safe, effective and environmentally sound marine services responsive to the needs of Canadians in a global economy.

Fisheries and Oceans spends more than $1.4 billion annually. The largest part of these expenditures relates to the Canadian Coast Guard activities. The Coast Guard's activities include Marine Navigation Services; Marine Communications and Traffic Services; Icebreaking Operations; and Rescue, Safety and Environmental Response. As well, the Coast Guard operates a fleet of vessels in support of the Department's other primary business lines: Fisheries and Oceans Science, Habitat Management and Environmental Science, Hydrography, Fisheries Management and Harbours.

Our findings should be viewed in the context of the major changes that the Department has undergone in the past few years. In 1995-96, as part of the government's Program Review exercise, Fisheries and Oceans almost doubled in size with its merger with the Canadian Coast Guard, transferred from Transport Canada.

Within the last four years, the Department has introduced new financial and human resource information systems. It continues to deal with government-wide issues such as the Universal Classification System, the Financial Information Strategy and the Modernization of Comptrollership initiative. Finally, during this period, there has been a high turnover in senior management. When combined, these factors have limited the Department's ability to solidify its financial management foundation and move forward with confidence. However, the Department is making progress and has several projects under way that are designed to further improve its financial management capability.

Scope of our work

In examining Fisheries and Oceans, we concentrated our efforts on four business lines: Fisheries Management; Hydrography; Harbours; and Rescue, Safety and Environmental Response. The audit included the Newfoundland and Pacific regions and departmental headquarters. Our Office is currently completing a separate audit of the Coast Guard's fleet management. Financial management issues as they pertain to the fleet will be included in our December 2000 Report.

Summary assessment

Fisheries and Oceans has substantially met the requirements of five of the eight key process areas of the Control Level of the Financial Management Capability Model. While the Department has established many of the basic financial management capabilities, we found that a gap remains between current expectations for financial management and the Department's existing capabilities. We noted that the capabilities related to internal controls management, data management, and planning and budgeting need to be strengthened.

We also noted that the Department has a number of initiatives that are designed to develop the capabilities of the Information Level of the Model. Capabilities at this level are generally those that departments will need to meet all of the objectives of the government's Financial Information Strategy and Modernization of Comptrollership initiative.

Listed below are certain strengths that we noted during our audit. We have also described specific weaknesses related to the Control Level.

Strengths

Organization control environment. Fisheries and Oceans has developed and instituted a strategic plan, and vision and mission statements that are well known and communicated to all employees throughout the Department. During the past year, drafts of these documents have been used for the first time to guide the planning and budgeting process. The departmental structure is well defined and documented.

Financial management environment. Fisheries and Oceans has implemented a comprehensive financial management training and reference tool to disseminate accounting policies, procedures and common forms on a Department-wide basis. "Finance and Administration 101" on the Department's Intranet serves as both a training module and reference source. The tool is designed to reduce errors and help in applying financial and administrative practices consistently in all regions and program areas.

Weaknesses

Internal controls management. Although the Department has developed an internal control framework, it has neither communicated the framework throughout the Department nor ensured that controls are operating effectively. No performance measures are in place to monitor the effectiveness of the framework, and limited independent review is conducted to ensure that controls meet the Department's needs. Internal audit needs to strengthen its capacity to provide assurance on the adequacy of departmental control systems.

Data management. While individual transactions are usually correct (for example, cheque amounts have been calculated correctly), the allocation and distribution of expenditures are neither accurate nor timely. As a result, program managers do not believe that they have the financial information they need to manage their programs. Many of the Department's information systems rely on program areas to input source data. In certain cases, the data are not being accurately input on a timely basis. Two consequences of this are decreased efficiency and an inability to aggregate information at a departmental level. To compensate for these weaknesses in financial data, many departmental managers maintain separate books and records.

Planning and budgeting. The Department has recently developed a long-term capital plan and an inventory of its real property assets; these two initiatives were overdue. However, the Department has yet to establish the optimum complement of assets that will be needed to deliver its programs economically and effectively.

***Department's response**: Fisheries and Oceans agrees with many of the observations in this chapter. The Department has substantially met the requirements of five of the eight key process areas, but acknowledges that work remains to be done in the remaining areas, particularly if such key priority initiatives as Results for Canadians, the Financial Information Strategy and the Modernization of Comptrollership initiative are to be successfully implemented. The Financial Management Capability Model is a framework for strengthening financial management through many small, evolutionary steps. While a fully mature financial management regime cannot be achieved overnight, Fisheries and Oceans is committed to finding the ways and means to continually improve its key process areas.*

Health Canada

Background

Health Canada's mission is to help the people of Canada maintain and improve their health. Its mandate covers three broad areas — national health policy and systems, including health care; health promotion and protection, including prevention of disease, illness and injury; and First Nations and Inuit health.

Health Canada's planned spending for fiscal year 1999-2000 was about $2 billion. These expenditures were made to support Health Canada's primary business lines: Management of Risks to Health; Promotion of Population Health; Aboriginal Health; Health System Support and Renewal; Health Policy, Planning and Information; and Corporate Services.

Within the last four years, Health Canada has had to deal with government-wide initiatives such as Year 2000 readiness, the Universal Classification System, the Financial Information Strategy and Modernization of Comptrollership. As well, the pressures on Canada's health care system have increased in recent years.

During our audit, Health Canada implemented a new financial system as part of its Year 2000 readiness and to strengthen its financial management capabilities.

Scope of our work

We focussed our work on the following areas of the Department: Corporate Services Branch; Medical Services Branch; Health Protection Branch; and Information, Analysis and Connectivity Branch. The audit included departmental headquarters and the Central Region.

Summary assessment

Health Canada has substantially met the requirements of three of the eight key process areas of the Control Level of the Financial Management Capability Model. While the Department has established many of the basic financial management capabilities, we found that a gap remains between current expectations for financial management and the Department's existing capabilities. We noted that the capabilities related to internal controls management, data management, general accounting, planning and budgeting, and operations control need to be strengthened.

We also noted that the Department has a number of initiatives that are designed to develop the capabilities of the Information Level of the Model. These capabilities are generally those that departments will need in order to meet all of the objectives of the government's Financial Information Strategy and Modernization of Comptrollership initiative.

Listed below are certain strengths that we noted during our audit. We have also described specific weaknesses related to the Control Level.

Strengths

Organization control environment. Health Canada has a clearly defined mission and vision. Staff have a strong commitment and understanding of the Department's mandate and their role in achieving the mission.

Financial management environment. Health Canada has developed a Policy Centre on its Intranet to disseminate accounting policies and procedures on a Department-wide basis. This access to the Department's policies serves as a reference source and is designed to reduce errors and to help ensure that financial and administrative practices are applied consistently in all regions and program areas.

Weaknesses

Internal controls management. Although important components of internal control are in place in Health Canada, a departmental control framework is neither firmly established nor well documented. Strengthened monitoring by management of the effectiveness of the control framework, including reporting against performance measures, is needed to ensure that the controls are effective and operating as designed. Internal audit needs to strengthen its capacity to provide assurance on the adequacy of the departmental control systems.

Data management. We noted the lack of accuracy and timeliness of financial data (e.g. salary data) recorded in the Department's previous financial systems. As a result, many program managers do not believe that they have the financial information they need to manage their programs. During the audit, the Department introduced a new financial system that is designed to strengthen the accuracy and timeliness of financial data. In the early stages of its implementation, we noted that users found the new system cumbersome to use and difficult to obtain information from. Additional effort is needed to train system users, and to ensure that they understand the operation and capabilities of financial systems and their responsibilities to record and monitor transactions in a timely fashion. The Department also needs to address the remaining system problems that affect the accuracy of some salary data.

General accounting. We noted that Health Canada has not been able to reconcile either its new financial system or its previous system to the Receiver General's central accounting system. Such a reconciliation is an important step for verifying and ensuring the integrity of the financial data in departmental systems. The consequences of this weakness include non-compliance with Receiver General directives and an inability for the past two years to complete the Public Accounts reporting requirements on time.

Planning and budgeting. Formal and systematic planning and budgeting practices are carried out at the corporate level to support the appropriation process. However, we noted that at the branch and directorate levels there is no up-to-date operational planning framework in place; as a result, planning is generally not performed in a consistent manner across the organization. The Department needs to update its departmental planning processes to facilitate the integration of the various planning mechanisms currently being used.

Operations control. A primary concern is that many managers do not have the information, relating financial with non-financial measures, that they need to manage and monitor their programs. To compensate for weaknesses in corporate financial systems, many individual managers have developed their own duplicate systems to track operations and expenditures. A consequence of this is decreased efficiency and the inability to aggregate information at a corporate level.

Department's response: *Effective 1 April 1999, Health Canada successfully implemented a new financial system with vastly improved capabilities. Fully utilizing all the capabilities of the new system will take time and a sustained investment in training. To date, over 2,500 employees have been trained. Many of the concerns expressed in the case study are consistent with what has been addressed or is being addressed as part of a financial management improvement plan. Health Canada has placed a high priority on strengthening its financial management capabilities; this is indicated by its investment in a new financial system, the effort in employing more qualified staff, the plan to implement the Financial Information Strategy, the steps being taken to strengthen the internal audit capacity, and its expectations for sound management practices embodied in the concepts of modern comptrollership and reflected in the Department's financial management improvement plan.*

Transport Canada

Background

Transport Canada is responsible for most of the transportation policies, programs and goals set by the government to ensure the safety, efficiency and accessibility of the national transportation system.

Transport Canada's planned net program spending for the fiscal year 1999-2000 was $901 million. These expenditures are aimed at providing the best possible transportation for Canada and Canadians and supporting the Department's primary business lines: Safety and Security, Programs and Divestiture, Policy, and Departmental Administration.

Scope of our work

We examined the Department's four business lines and conducted our work in the Ontario region and at departmental headquarters in Ottawa.

Summary assessment

Transport Canada has substantially met the requirements of seven of the eight key process areas of the Control Level of the Financial Management Capability Model. While the Department has established most of the basic financial management capabilities, we found that a gap remains between current expectations for financial management and the Department's existing capabilities. We noted that capabilities related to internal controls management need to be strengthened to provide assurance to senior management that the control framework is working as intended.

We also noted that the Department is at the initial stages of developing the capabilities of the Information Level. These capabilities are generally those that departments will need to meet all of the objectives of the government's Financial Information Strategy and Modernization of Comptrollership initiative.

Various organizational units in the Department perform elements of risk management, quality measurement and cost management. However, these capabilities are not undertaken within the context of departmental frameworks that are designed to provide a consistent approach across the organization.

Listed below are certain strengths that we noted during our audit. We have also illustrated a specific weakness related to the Control Level.

Strengths

Organization control environment. Transport Canada has a well-defined and documented organizational structure, and staff demonstrate a thorough understanding and awareness of departmental vision, mission and values at both departmental and branch levels.

General accounting. Transport Canada is moving toward implementation of the accrual accounting component of the Financial Information Strategy on 1 April 2001. The Department introduced an accrual-based accounting environment with the implementation of its IDFS financial system. While the accrual system works well, the Department expends significant effort and resources to reconcile differences between its accrual systems and the cash basis of accounting that is required for reporting to Parliament. Implementation of accrual appropriations would alleviate this task.

Risk management. Transport Canada has introduced risk management practices within significant operational activities. These practices are having an impact on critical decisions within the Department and are furthering efforts to optimize allocation of resources and improve safety. Although the Department does not yet have a Department-wide risk management framework, it expects that it will soon finalize such a framework.

Performance measurement. Transport Canada has recently instituted a corporate performance measurement framework that identifies specific outcomes and relates them to corporate objectives. These measures are tracked and monitored on a continuing basis.

Weakness

Internal controls management. Important components of internal controls are in place. We noted that management needs to increase monitoring of the control framework's effectiveness and strengthen the internal audit function. Internal audit provides limited assurance to senior management that the control framework is working as intended.

Department's response: *Transport Canada is pleased that the Office of the Auditor General recognizes the Department's strengths with respect to its financial management capabilities. As part of good management practice, the Department has a number of ongoing processes and initiatives to support management decision making. Following the divestiture of many of its operations, Transport Canada has taken steps to strengthen its internal audit capacity. For example, previous and current internal audits examine matters such as financial and administrative processes and practices, grants and contributions, and lease agreements.*

Transport Canada is committed to sound financial management. The audit confirms our understanding of areas where improvements may be made, and provides guidance on where the Department may focus its future efforts. The audit observations will be taken into consideration as part of Transport Canada's Comptrollership Modernization Initiative. The Department will also continue to strengthen its internal audit function to better monitor and provide assurance on the Department's financial, administrative and management controls. For example, Transport Canada is developing a comprehensive, risk-based audit program to assess expenditure items and agreements. This audit program will include periodic audits of Transport Canada's expenditures, contracts, third-party agreements, and administrative and management practices.

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Chapter 14
Canadian International Development Agency – Managing Contracts and Contribution Agreements

October 2000

This October 2000 Report comprises 8 chapters as well as a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 14

Canadian International Development Agency

Managing Contracts and Contribution Agreements

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Canadian International Development Agency

Managing Contracts and Contribution Agreements

Main Points

14.1 In CIDA's Geographic programs, contracts and contribution agreements with Canadian executing agencies are used to implement development projects. Where CIDA used a competitive process for selecting executing agencies, with some exceptions the process was properly conducted. However, we observed instances where contracts did not comply with the Treasury Board Contracting Policy or the Government Contracts Regulations.

14.2 An authority framework, similar to that for the contracting process, is not in place for CIDA's contribution agreements. The terms and conditions for grants and contributions related to the Geographic programs are very general and provide no direction on how and when to use contribution agreements. They include a provision that contributions are to be approved in accordance with regular departmental procedures and authorities; however, exceptions can be dealt with internally by CIDA. Consequently, CIDA's use of contribution agreements to select executing agencies often varied from its stated internal policies or practices. CIDA can select executing agencies by means of contribution agreements, which are, in effect, the same as sole-source contracts that would not be permitted under Government Contracts Regulations. This was the case in about half of the contribution agreements we examined.

14.3 CIDA project officers attach considerable importance to monitoring the agreements under their responsibility. They commonly use monitors under contract to review and report on progress, and they insist on receiving reports from Canadian executing agencies as required.

14.4 For the Voluntary Sector program, the Canadian Partnership Branch obtains reasonable information on the financial health of its Canada-based partners. However, limited information is received on projects that were funded, on the amounts spent on them, and on results obtained. CIDA bases its funding primarily on historical levels rather than on partners' performance. More meaningful and accurate information on the Canadian Partnership Branch is needed in CIDA's Performance Report to Parliament.

Background and other observations

14.5 CIDA is responsible for managing about $1.8 billion of Canada's international assistance. Approximately $700 million of that amount goes to Geographic Branches for programs aimed at countries in Asia, Africa and Latin America. Most of this amount is spent through contracts and contribution agreements with third parties, referred to as executing agencies, to deliver development assistance projects. Another $260 million goes to the Canadian Partnership Branch for grants and contributions to organizations to carry out their own aid programs.

14.6 In 1998, our Office published a report that commented on results-based management related to Geographic programs. We concluded that progress in managing for results was evident but uneven.

14.7 This audit focussed on how CIDA's Geographic Branches manage contracting and other types of agreements for goods and services, including the selection of Canadian executing agencies to deliver projects. It also examined the control framework for agreements in the Canadian Partnership Branch's Voluntary Sector program. The audit aimed to assess whether CIDA's contracting/contribution agreement processes respect Government Contracts Regulations, Treasury Board guidelines and its own policies; whether they are fair and transparent; and whether they meet operational requirements and development needs.

The Agency's responses to our recommendations are included in this chapter. The Agency accepts the recommendations and indicates the actions that it is taking or intends to take to address them.

Introduction

CIDA uses contracts, contribution agreements and grants to deliver its development assistance

14.8 Nearly all of CIDA's budget for 1999–2000 ($1.7 billion or about 93 percent) is allocated to development assistance programs. The planned spending by program for this period is shown in Exhibit 14.1. Operating and capital expenditures of $131 million (about seven percent) make up the rest of the budget. CIDA's program expenditures of $1.7 billion are made in the form of grants, contributions and other transfer payments. These payments are made to Canadian and developing country institutions, provincial governments and their organizations and agencies, and Canadian private-sector firms, for specific development projects, programs and activities. Exhibit 14.2 shows the distribution of agreements by dollar value in the Geographic Branches, excluding food aid.

14.9 The Geographic Branches carry out Geographic programs, also referred to as bilateral or country-to-country programs; these programs account for about 40 percent of CIDA' s program expenditures. The Geographic Branches also carry out development co-operation initiatives, mostly through Canadian executing agencies, directly with countries eligible for Canadian aid. The projects aim to reflect both the needs of developing countries and Canada's ability to meet those needs.

14.10 CIDA' s Canadian Partnership Branch promotes partnerships between developing countries and organizations based in Canada and internationally, to support sustainable development and reduce poverty in the developing world. The Branch provides grants and contributions to support partner organizations that are responsible for the design, planning and implementation of the development programs and projects.

Focus of the audit

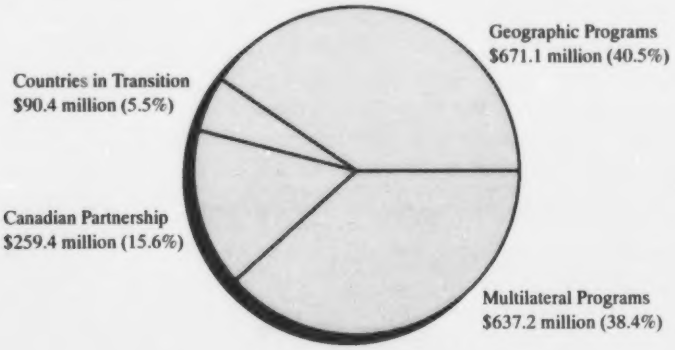
14.11 The objectives of our audit were to assess whether CIDA's contracting/contribution processes:

- respect Government Contracts Regulations, Treasury Board guidelines and its own policies;
- are fair and transparent; and
- meet operational requirements and development needs.

14.12 The audit focussed on how CIDA's Geographic Branches manage contracting and other types of agreements for goods and services, including the selection of Canadian executing agencies to deliver projects.

Exhibit 14.1

CIDA's Program Budget for 1999-2000



TOTAL = $1,658.1 million

Source: CIDA

14.13 The audit also examined the control framework for program funding agreements in the Voluntary Sector program of the Canadian Partnership Branch. This program supports programs and projects planned, designed and implemented by the voluntary sector.

The awarding of contracts for both aid and corporate services is subject to Government Contracts Regulations (GCRs) and Treasury Board Contracting Policy. CIDA's contribution agreements are not subject to the GCRs.

14.14 Sampling plan. In the Geographic Branches, agreements with a value of over $100,000 account for over 90 percent of the total value of all agreements. We selected a random sample of 33 agreements over $100,000, with a total value of $214 million, in six chosen countries in the three-year period 1996–97 to 1998–99. The selection of countries reflected the dollar importance of each region and our discussions with CIDA. The six countries chosen were Peru, China, India, Cameroon, Egypt and Mali. The sample included six agreements over $10 million and three food aid contracts. In order to ensure the currency of our findings, we also chose a small random sample of eight projects from the 1999-2000 year for a file review. In addition, we selected a random sample of seven partnership agreements, with at least one project in one of the six countries. Further details on the audit are in **About the Audit** at the end of the chapter.

Policy Framework

CIDA authorities for contracts and contribution agreements

14.15 The awarding of contracts for both aid and corporate services is subject to Government Contracts Regulations (GCRs) and Treasury Board Contracting Policy. CIDA's contribution agreements are not subject to the GCRs and are governed by the terms and conditions for grants and contributions related to the Geographic programs approved in March 1996, and by the terms and conditions for the Canadian Partnership Branch approved in March 1995.

14.16 The Geographic Branches' Geographic Programs Roadmap sets out the monetary approval authority limits for both contracts and contribution agreements. The level of approval required for a project depends on its dollar value. Projects between $500,000 and $5 million require approval by a vice-president; projects between $5 million and $15 million need the Minister's approval; and projects over $15 million must be approved by the Treasury Board. Partnership grants and contributions are based on cost sharing with partners. The limits for partnership agreements are $5 million per year up to $15 million under multi-year funding agreements.

CIDA's policy framework for contracts and contribution agreements in the Geographic Branches

14.17 Policies in effect before 1997 relating to competitive contracts. Prior to 1997, there were two phases to the competitive contracting process. The first phase involved an invitation to prequalify. CIDA put its request on the open bidding system and invited bidders to make simple, short proposals that allowed CIDA to identify those who met the requirements. The proposals were to include the bidder's experience and achievements, key personnel, and

Exhibit 14.2

Spending by Type of Agreement and Fiscal Year

Geographic Branches Agreements Over $100,000 by Dollar Value				
Type of Agreement	**1996–1997**	**1997–1998**	**1998–1999**	**1999–2000**
Contracts	48%	45%	54%	43%
Contributions	45%	40%	37%	45%
Inter-governmental	7%	15%	9%	12%

Source: CIDA

management/financial capability. There was no costing done at this phase of the process. CIDA then established a review committee to evaluate the proposals and retain those that met the standards. The committee submitted the list to the Minister, who selected three to five candidates for prequalification.

14.18 In the next phase of the process, the prequalified candidates were requested to submit detailed proposals. These proposals included a detailed costing and total bid price. The bid evaluation team examined the bids and prepared an evaluation report. An Evaluation Review Board reviewed the report and made a final recommendation to the Minister. Following this process, CIDA negotiated the contract terms and final amount with the successful bidder.

14.19 Policies and practices prior to 1997 relating to contribution agreements. Prior to 1997, CIDA's policy called for the use of contribution agreements for "country focus" projects delivered by not-for-profit organizations. One of the distinctive features of the country focus approach was that in most cases it was to be used for projects that were initiated, developed and approved by the not-for-profit organization implementing them. The not-for-profit organization was not hired to implement a project for CIDA but received support for a project of its own.

14.20 By 1996, it had become common practice for CIDA, when engaging a Canadian executing agency for a project, to use contribution agreements whenever dealing with not-for-profit organizations, even for CIDA-initiated projects. There was no requirement that contribution agreements be tendered competitively and they could provide for reimbursements of up to 100 percent of costs. Once awarded, contribution agreements are managed by CIDA in much the same way as contracts.

14.21 Changes as of 1997. On 10 December 1996, CIDA's Minister announced the implementation of an Open Competition Pilot Project for all agreements over $100,000 in the Geographic Branches. This initiative was designed to allow both for-profit and not-for-profit organizations equal access to service contracts over $100,000 as well as to the Bilateral Responsive Mechanism for unsolicited proposals. This meant that not-for-profit organizations could compete for service contracts and that for-profit organizations could enter into contribution agreements with CIDA. The Agency emphasized that a competitive contracting environment is to be the chief mechanism for delivering the assistance program. Under this initiative, contribution agreements would be used for unsolicited proposals through the Bilateral Responsive Mechanism, which does not require agreements to be open to competition.

14.22 CIDA issued guidance on the awarding of contribution agreements for unsolicited proposals. The guidance makes clear that, under the Bilateral Responsive Mechanism, contribution agreements are to be used as a vehicle for engaging Canadian executing agencies only when the project was initiated by the proposing entity. The guidance states that in order to help differentiate sole-source "responsive" projects from "directed" projects, it is important that responsive projects:

- be unsolicited proposals from eligible development partners;
- be implemented under a contribution agreement between the implementing organization and CIDA; and
- require that project approval and the selection of the implementing organization be inseparable.

14.23 Once CIDA decides that a project qualifies as responsive, it can then determine whether and to what extent it

Under the country focus approach, in most cases contribution agreements were to be used for projects that were initiated, developed and approved by the not-for-profit organization implementing them.

As of 1997, not-for-profit organizations could compete for service contracts, and for-profit organizations could enter into contribution agreements with CIDA.

wishes to contribute toward furtherance of the project. No profit is allowed to the project proponent.

14.24 For competitive contracts, the prequalification phase of the selection process was discontinued.

14.25 In December 1997, CIDA incorporated these changes into its Geographic Programs Roadmap, which provides the policy and regulatory context for the conduct of the Bilateral Aid Program. In November 1999, CIDA issued a draft Contracting Guide for Managers in CIDA. The final version of the Guide was issued officially in May 2000. This guide contains CIDA's key contracting policies and reinforces the direction taken by the Open Competition Pilot Project toward increasing competition.

CIDA's policy framework for grant and contribution agreements in the Canadian Partnership Branch

14.26 The 1998-2001 Branch Plan of the Canadian Partnership Branch (CPB) outlines the policy framework within which the Branch operates. Key features of this framework are the following:

- **Responsiveness.** CPB's Canadian partners are responsible for the planning and implementation of their own policies, programs and projects in collaboration with their developing country partners. Responsibility for and "ownership" of the programs and projects supported through CPB belong to the Canadian or international partner and its partner overseas. These programs and projects are not CIDA programs or projects.

- **Cost-sharing**. All Canadian and developing country partner organizations are required to contribute resources to their development initiatives.

- **Focus at the institutional level.** The Canadian Partnership Branch ensures the eligibility of the organizations receiving support and assesses the extent to which their programs reflect CIDA's programming priorities and objectives. The Branch is also accountable for assessing the financial, managerial and technical capabilities of partner organizations, and for verifying the results achieved.

Observations and Recommendations

Planning and Design

Contract plans were incomplete

14.27 Under CIDA policy, a contract plan must be prepared early in the project design stage. This plan sets the stage for all contracts or other arrangements needed to support the project. Among other items, the plan is to identify the selection method (competitive or non-competitive) and the type of executing agency (not-for-profit, private sector or other). We found that of the 12 non-competitive agreements that we examined where a contract plan was required, 8 did not address either the selection method or the type of executing agency to be used.

Unclear or unrealistic expectations affect contract performance

14.28 CIDA's Policy Statement on Results-Based Management specifically calls for "defining realistic expected results, based on appropriate analyses." We found that 15 of the 33 agreements in our sample had unrealistic or unclear expectations of what was to be achieved. In all but one case, the projects had dropped one or more of the major expected results or were significantly behind schedule. In the one case, the project team redefined an unclear objective and created clearer expectations, which were being met. In the other cases where the projects were behind schedule, we found no sound analysis (for example, critical path) of how the time could be made up (see Exhibit 14.3).

14.29 For the contracts in our sample, the project approval documents, the statements of work and the requests for proposal were consistent with each other. The statements of work were generally clear enough to permit CIDA to include in contracts the outputs that Canadian executing agencies were expected to deliver, and to enable CIDA to monitor project progress, notwithstanding whether these expected outputs were realistic.

14.30 One of the perceived advantages of tendering contracts for competition is that the process should lead to a tighter and better-understood description of the job to be carried out. We looked for reasons why so many contracts let competitively still had unrealistic expectations of results. We believe the main reasons are the following:

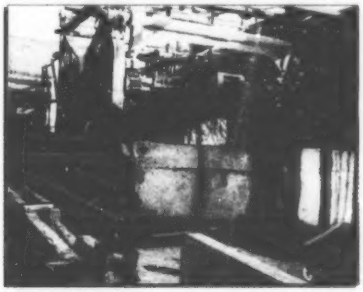
- Many projects are planned in considerable detail by CIDA staff, using outside consultants to assess feasibility. The consultants who assess the feasibility do not generally bid on the contract, and the time frames between the feasibility assessment and contract implementation can be measured in years. Competition for funding encourages CIDA staff, consultants and developing country officials to present anticipated project results as optimistically as possible, even if experience suggests that more modest expectations would be realistic.

- Bidders are required to bid on the project as described in the request for proposal. They are given points in the evaluation for their understanding of the project. During our audit, bidders told us that they could not consider making a bid that would indicate that project expectations are unrealistic, as they would then stand no chance of winning.

- CIDA's evaluation teams for tendered bids generally include the project team leader, who is the officer proposing the project and who has usually directed the design phase, and one or more technical specialists who understand the subject area. A contracting officer assists the team to ensure compliance with contracting policy. The evaluation team focusses on selecting the bidder with the best approach and experience, rather than on questioning whether the expected results are realistic.

Exhibit 14.3

Project With Unrealistic Expectations Falls Behind Schedule



A marble cutting saw in a small Egyptian firm. CIDA is helping with the purchase of a water purifier for this operation.

An $18 million project in Egypt was to set up a fund for small businesses to improve their environmental compliance with Egyptian law. CIDA expected that Egyptian small businesses would be eager to invest in projects of about $250,000 to comply with the law. This proved to be unrealistic, as the Egyptian government did not move as vigorously to enforce its environmental legislation as CIDA had assumed it would. The Canadian executing agency spent considerable effort to find three businesses willing to participate. At the time of our audit, the dollar value of the projects identified averaged $107,000. The portion paid from project funds averaged $32,000.

It took two years rather than one year to develop an inception report including an operational plan. The original plan had called for the pilot phase to last 12 months after the preparation of the inception report. When it was developed, the inception report planned to make up for lost time by reducing the pilot phase to between seven and nine months. At the time of our visit to the project, the nine months for the pilot phase had expired but the pilot projects had not begun. The pilot phase was crucial to validating the approach that had been developed and to working out the details of implementation. However, the Canadian executing agency was planning to meet deadlines by proceeding with implementation without the benefit of the results of the pilot.

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14.31 As part of the project approval process, CIDA should review more rigorously whether the expected results that have been established for projects are realistic.

Agency's response: *CIDA will place greater emphasis, as part of the project approval process, on ensuring that the established expected results for projects are realistic.*

Provisions for sustainability need to be built into agreements more consistently

14.32 In our 1993 chapter on Bilateral (Geographic) Programs, we outlined certain conditions for sustainability of benefits. CIDA incorporated this thinking into its results-based management framework (which we published in our 1996 follow-up chapter) by setting out four conditions for ensuring the sustainability of benefits:

- Stakeholders take charge of project activities.
- There is commitment of sufficient financial resources to maintain project benefits, where applicable.
- Institutional capacity and ongoing relevance are adequate to maintain project benefits.
- The national and international environments are conducive to maintaining project benefits.

14.33 During the audit, we examined contracts and contribution agreements with Canadian executing agencies to determine if they included any provision relating to conditions that would make sustainability of benefits more likely. There were 25 agreements where provisions relating to sustainability could have been considered. Of these agreements, 12 called for one or more of the conditions for sustainability to be addressed, while the other 13 did not. The following two cases provide examples; the first addressed sustainability and the second did not.

14.34 An $18 million contract for an environment development project in Egypt required the Canadian executing agency to spend the last two years of the project putting in place a transition strategy to turn over management and

Demonstration by a worker in a small metalwork industry. A CIDA project is providing counselling support to small and medium-size firms in one region in Egypt (see paragraph 14.32).

administrative responsibilities to local organizations.

14.35 A micro-finance project in Peru was to transfer from the Canadian executing agency to members of the credit union system knowledge and skills in the areas of marketing, information systems, banking procedures, management and audit. The agreement contained a training module but did not require testing of the credit union staff's capability before handover of the project. The agreement could also have required the Canadian executing agency to identify and develop the leadership skills of an organization to ensure that the knowledge and skills acquired by the member credit unions are maintained and further developed. This would have supported stakeholders in taking charge of project activities. A revised implementation plan has proposed to introduce an institution-strengthening component.

14.36 Although clauses in agreements with executing agencies are not the only way to help ensure that conditions for sustainability will exist, CIDA needs to continue to look at this option in its planning of agreements.

CIDA did not always comply with the *Canadian Environmental Assessment Act*

14.37 Under the *Canadian Environmental Assessment Act (CEAA)*, CIDA must examine proposed projects to determine the environmental effects of the project and make a decision on their significance. For each project, CIDA requires a preliminary environmental assessment form to be completed in the design stage, to establish whether the Act applies to the proposed project and whether an environmental assessment is required.

14.38 For projects that undergo an assessment, a completed environmental screening report must be filed in the public registry along with other project-related documents. The public registry is a public record of documentation related to any environmental assessments conducted for the projects. Neglecting to file the required documents in the public registry denies the public its legislated right to participate in the environmental assessment process.

14.39 An internal audit found that only about five percent of new CIDA initiatives require an environmental assessment under the Act. The number of applicable

The San Hilarion Cooperative, which is located on the outskirts of Lima, Peru, is one of the institutions participating in the micro-finance project. The implementation of the project at this Cooperative began in March 2000 (see paragraph 14.35).

cases is relatively small, but in 41 percent of those cases, the audit concluded that CIDA was not complying with the requirement to conduct an environmental assessment prior to a funding decision.

14.40 Of the projects we examined, two required environmental assessments. Only one was found in the public registry and it had been filed late. The project included the construction of health centres in China. The original preliminary environmental assessment form indicated that the *CEAA* did not apply. However, in this instance, the Act did apply to the construction activities. CIDA discovered its oversight some time later, but the host country partner began construction before the required assessments were completed. After reviewing those assessments, CIDA required ongoing monitoring of the facilities for potential adverse environmental impacts. Although the monitoring was done, CIDA did not file the monitoring reports in the public registry as required. The assessment of the other project was not found in the public registry but did not raise any environmental concerns.

14.41 The Mali Mortgage Financing project (see the case study on page 14-15) is a case where the original project plan correctly indicated that the *CEAA* did not apply. However, as the project progressed, the Canadian executing agency's activities were expanded to include co-ordinating housing development to stimulate demand for mortgages. This made necessary a new preliminary environmental assessment, as housing development typically triggers the application of the Act. Following the approval of the new activities, no review of the project was conducted to determine if the Act applied.

14.42 Environmental assessments serve to bring forward environmental considerations in the project planning and design stages. Conducting the assessment after the start-up of a project is almost equivalent to not conducting one at all. CIDA's Executive Committee approved new environmental assessment directives and agreed that the Agency strive for full compliance with the *CEAA* by

A village doctor who received training from the Yunnan Maternal and Child Health Project speaks about maternal health issues to a group of women at the Toutai Administrative Village Clinic in Yunnan Province (see paragraph 14.40).

1 July 2000. An Environmental Assessment Co-ordinating Committee was established to assist with this effort.

Selection

Contribution agreements were used instead of competitive contracts

14.43 In our 1999 chapter on sole-source contracting and the use of advance contract award notices (ACANs), we stated:

> Contracting is an essential tool for federal departments and agencies in delivering programs. Central to government contracting are the principles of best value and open access to contracting opportunities. "Best value" is the best combination of value and price that the government can obtain in acquiring goods or services for the Crown. "Open access" is a fair chance for all qualified vendors to do business with the Crown without political or bureaucratic favour. An open, competitive bidding process provides the best guarantee that both of these principles will be respected. The Government Contracts Regulations state that competition is the norm, and departments are to solicit bids before entering into a contract.

14.44 Over the years, CIDA has subscribed to this principle for contracts but not for contribution agreements. Until 1997, CIDA traditionally used the non-competitive vehicle of contribution agreements when choosing a not-for-profit organization, and competitive contracts when choosing a for-profit organization as a Canadian executing agency. Exhibit 14.4 shows the percentages, in terms of dollar

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Mali Mortgage Financing Project

Background

The main output of this project is to establish a loan guarantee system to facilitate access by Malian people to property ownership. It intends to stimulate economic activity related to the construction sector and therefore help the poor. CIDA signed a contribution agreement of $4.7 million with a not-for-profit Canadian executing agency for this project.

A contribution agreement was awarded instead of a competed contract

CIDA identified this as a possible project in meetings with the Malian government in 1994. CIDA had a feasibility study done by the not-for-profit organization and the Canada Mortgage and Housing Corporation in February 1996. In May 1996, CIDA asked for and obtained authorization from the Minister to enter into a contribution agreement with the same not-for-profit organization for the implementation of the project. In our view, because CIDA initiated this project, it did not meet the conditions for a project under the country focus approach. A competitive process should have been used.

CIDA was slow to react when assumptions critical to the project's success were not met

The feasibility study identified several assumptions critical to the start of the project. Two involved amendments to Malian legislation. The Malian government agreed in its Memorandum of Understanding with CIDA that these legislative changes were critical to the project and that they would be implemented before the project team arrived. Three months prior to the scheduled mobilization of the Canadian executing agency staff to Mali, a CIDA mission identified a complete lack of progress toward the legislative changes. Despite this fact, CIDA instructed the Canadian executing agency to begin its operations in Mali and help the Malian government draft the legislative changes.

The Canadian executing agency spent considerable time in the first seven months of the project drafting the legislative amendments. This was not part of the original plan. Almost two years after the start of the project, the Malian legislature has not yet passed the changes. About eight months into the project, the project team, made up of both Canadian and Malian staff, also discovered that approval from the Central Bank of the West African States is required to issue loan guarantees. The Canadian executing agency failed to identify this critical condition in both its feasibility study and inception report. The Canadian executing agency then spent one year preparing to meet the approval conditions in order to apply to the Central Bank. The project team is now waiting for the Central Bank's decision.

No loan guarantees — the main output of the project — have been processed so far. The original plan had called for 1,400 out of 8,300 guarantees to have been issued in the first two years. The current annual work plan shows no change in the total number to be issued, but does not explain how the project team plans to catch up.

Lack of necessary involvement of host country causes project delays

This project also shows the difficulty of fostering development in a bilateral context. The planning documents for this project called for the Malian government to contribute about $1 million (400 million CFA francs) to the project. The MOU, which was signed later, required the amount to be taken out of the Malian counterpart fund, which is also completely financed by CIDA. We could find no rationale on file explaining such a significant change to the Malian government's responsibilities on the project. The current situation is a project that is financed 100 percent by CIDA, in serious difficulty and waiting for the local government to act.

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value, of competitive and non-competitive agreements over $100,000 signed in the Geographic Branches from 1996-97 to 1999-2000. These include goods and services contracts and contribution agreements.

14.45 With the advent of the Open Competition Pilot Project (OCPP) that the Minister announced in early December 1996, CIDA indicated that contribution agreements would be used for unsolicited proposals. Not-for-profit organizations would henceforth be encouraged to compete with for-profit organizations for contracts to deliver CIDA aid, and for-profit organizations would be eligible to receive contributions, on a non-competitive basis.

14.46 The contracts and contribution agreements that we selected were from those signed in the years 1996-97 to 1998-99. The contribution agreements dated beyond 1997 should have followed the procedures of the Bilateral Responsive Mechanism unless the selection process had already begun under the previous policy framework. Those agreements whose selection process had begun before 1997 should have followed the country focus approach. In both time periods, contribution agreements were to be used for what CIDA now terms unsolicited proposals.

14.47 We concluded from our examination that 6 contribution agreements out of 11 that we examined were initiated by CIDA, rather than the not-for-profit organization. Consequently, a competitive process should have been considered for the selection of the executing agency. The case study on page 14-15 provides an example where competition should have been considered but was not. The following case is another example.

Exhibit 14.4

Percentages of Competitive and Non-Competitive Agreements Over $100,000 in the Geographic Branches, by Dollar Value

	1996-1997	1997-1998	1998-1999	1999-2000
Competitive agreements	48%	53%	61%	48%
Non-competitive agreements	52%	47%	39%	52%

Source: CIDA

14.48 In May and December 1996, CIDA awarded two contribution agreements to a Canadian not-for-profit organization to design and implement a health project in China. The total value of the agreements was $5.4 million. The government of China had requested Canadian assistance in May 1995 to carry out this project. CIDA undertook a feasibility mission in February 1996. The consultants who carried out the mission identified the necessary experience and expertise that would be required of a Canadian executing agency. In making its selection, CIDA decided to sole-source the design and implementation of the project through contribution agreements, even though the project was initiated by CIDA and the selection approval memorandum noted that more than one supplier was available.

14.49 We noted that CIDA did hold a competition to select an executing agency for each of two contribution agreements in our sample. The requests for proposal were sent to not-for-profit organizations. Both projects were awarded before the Bilateral Responsive Mechanism was adopted in 1997. Although in accordance with the country focus approach, these were not unsolicited proposals, the process was in the spirit of greater fairness and transparency.

14.50 We noted another instance where two very similar projects in two countries were treated quite differently under similar circumstances (see Exhibit 14.5).

14.51 CIDA conducted a performance review of the Open Competition Pilot Project in early 1999. One of the main conclusions from the performance review was that the restriction to the use of contribution agreements for unsolicited proposals was not well understood or applied. Among the weaknesses that CIDA staff identified for the reviewers were the lack of clear distinction between directed sourcing and unsolicited proposals, the lack of clear directives on the extent of the involvement allowed for project officers to assist or give advice on proposals, and the need to discuss and resolve some remaining ambiguities associated with "solicited unsolicited proposals."

14.52 In our selected sample of eight contracts and contribution agreements from 1999-2000, we looked to see if the 1997 policy direction was being consistently followed. Of three contribution agreements classified as unsolicited proposals, in our view two should have been opened to competition because they did not meet the conditions of the Bilateral Responsive Mechanism. The "unsolicited" criterion for contributions is still not completely understood at CIDA.

14.53 Framework for contracts and contribution agreements. Contracting activities take place within a well-established management framework with underlying principles of best value and open access. Activities are governed by the Government Contracts Regulations, and competition is the norm. Exceptions are permitted in certain limited circumstances and must be fully justified on the contract file or in a submission to the Treasury Board. However, no similar framework at the level of GCRs exists for entering into contribution agreements for CIDA projects, even though these are virtually identical to contracts.

14.54 CIDA's authority to use contribution agreements to implement its projects is governed by the terms and conditions approved by the Treasury Board in March 1996. The terms and conditions are very general and provide no

The terms and conditions for contribution agreements are very general and provide no direction on how or when to use contribution agreements.

Exhibit 14.5

Use of a Contribution Agreement Instead of a Competitive Contract

A company implemented the pilot phase of similar projects in Cameroon and Côte d'Ivoire. For the second or main phase, CIDA chose the competitive contract route in the project in Cameroon and selected a winning bidder. The company that implemented the pilot phase in Cameroon did not win the contract. For the Côte d'Ivoire project, CIDA chose not to go to competition and entered into an $8.5 million contribution agreement with the company that had carried out the pilot phase. This was the same company that had bid unsuccessfully on the project in Cameroon. Both events happened at around the same time. In the competitive process, the winning bidder was selected 13 October 1995 and the contract was signed 10 May 1996. The non-competitive contribution agreement was signed 7 June 1996. In the project involving the contribution agreement, CIDA had planned to award a sole-source contract. Planning had advanced to the point that CIDA had obtained the Minister's approval of the project on 10 May 1996, and had sent a submission to the Treasury Board requesting authority to enter into an $8.0 million sole-source contract and for retroactive approval of the sole-source contract awarded for the pilot phase. However, according to information on file, Treasury Board staff indicated that they were very uncomfortable with the submission and suggested that CIDA take advantage of recent changes permitting it to enter into contribution agreements with private companies. CIDA decided not to proceed with its submission and retained the company on a sole-source basis using a contribution agreement under its Bilateral Responsive Mechanism. We could not find an approval document signed by the Minister authorizing the use of a contribution agreement, although there was a reference on file that the Minister and President of CIDA had requested the negotiation of a contribution agreement with the company. This decision appears to have been made on 3 June 1996 and the agreement was signed four days later.

Under CIDA's Bilateral Responsive Mechanism, because the project proponent is to be the originator of the project and make a contribution proportional to its commitment, no profit may be associated with the project and contribution agreement. However, all CIDA's planning had been done on the basis of a sole-source contract, which included a normal provision for profit. We noted that the contribution agreement contained almost the same amount for fees as was included in the proposed contract, and there was no analysis of how the agreement complied with the no-profit provision.

contribution agreements for unsolicited proposals was not well understood or applied. Among the weaknesses that CIDA staff identified for the reviewers were the lack of clear distinction between directed sourcing and unsolicited proposals, the lack of clear directives on the extent of the involvement allowed for project officers to assist or give advice on proposals, and the need to discuss and resolve some remaining ambiguities associated with "solicited unsolicited proposals."

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Exhibit 14.5

Use of a Contribution Agreement Instead of a Competitive Contract

A company implemented the pilot phase of similar projects in Cameroon and Côte d'Ivoire. For the second or main phase, CIDA chose the competitive contract route in the project in Cameroon and selected a winning bidder. The company that implemented the pilot phase in Cameroon did not win the contract. For the Côte d'Ivoire project, CIDA chose not to go to competition and entered into an $8.5 million contribution agreement with the company that had carried out the pilot phase. This was the same company that had bid unsuccessfully on the project in Cameroon. Both events happened at around the same time. In the competitive process, the winning bidder was selected 13 October 1995 and the contract was signed 10 May 1996. The non-competitive contribution agreement was signed 7 June 1996. In the project involving the contribution agreement, CIDA had planned to award a sole-source contract. Planning had advanced to the point that CIDA had obtained the Minister's approval of the project on 10 May 1996, and had sent a submission to the Treasury Board requesting authority to enter into an $8.0 million sole-source contract and for retroactive approval of the sole-source contract awarded for the pilot phase. However, according to information on file, Treasury Board staff indicated that they were very uncomfortable with the submission and suggested that CIDA take advantage of recent changes permitting it to enter into contribution agreements with private companies. CIDA decided not to proceed with its submission and retained the company on a sole-source basis using a contribution agreement under its Bilateral Responsive Mechanism. We could not find an approval document signed by the Minister authorizing the use of a contribution agreement, although there was a reference on file that the Minister and President of CIDA had requested the negotiation of a contribution agreement with the company. This decision appears to have been made on 3 June 1996 and the agreement was signed four days later.

Under CIDA's Bilateral Responsive Mechanism, because the project proponent is to be the originator of the project and make a contribution proportional to its commitment, no profit may be associated with the project and contribution agreement. However, all CIDA's planning had been done on the basis of a sole-source contract, which included a normal provision for profit. We noted that the contribution agreement contained almost the same amount for fees as was included in the proposed contract, and there was no analysis of how the agreement complied with the no-profit provision.

direction on how or when to use contribution agreements. Direction is provided in several documents referred to in CIDA's Framework Policy for Bilateral Aid. The terms and conditions also include a provision requiring that contributions are to be reviewed and approved in accordance with regular departmental procedures and authorities. However, exceptions can be dealt with internally. Consequently, when CIDA wishes to make an exception to its own policies on the use of contribution agreements, it is able to do so with no requirement to justify the exception. We observed several instances where, in effect, CIDA's use of a contribution agreement to select an executing agency was the same as using a sole-source contract — which would not have been permitted under the Government Contracts Regulations.

14.55 CIDA's terms and conditions for grants and contributions related to the Geographic programs are due for renewal in March 2001. This will provide an opportunity to establish a clearer authority framework for the use of contribution agreements by the Geographic Branches to fund projects. Projects that do not meet the description of unsolicited proposals as described in CIDA's current policy for the Bilateral Responsive Mechanism should be tendered for competition.

14.56 When CIDA seeks Treasury Board approval for renewal of its terms and conditions, the Agency should include a framework that makes it clear how and when contribution agreements will be used in the Geographic programs.

Agency's response: *CIDA will continue to use contribution agreements under the terms and conditions for grants and contributions related to the Geographic programs approved by the Treasury Board. However, it will introduce a more structured framework to better guide the use of contribution agreements, especially those that are not for unsolicited proposals. CIDA will enhance its use of contracts to better reflect this as one of the key mechanisms for the delivery of its aid programs. The two mechanisms are intended to complement each other.*

14.57 A separate group within CIDA should review all proposed non-competitive contracts and contribution agreements over $100,000 for compliance with authorities and CIDA policy.

Agency's response: *CIDA will expand the mandate of its separate group in the branches to cover the review of contract plans over $100,000 for compliance with authorities and CIDA policy.*

14.58 There were also two directed contracts out of our sample of 15 contracts that, according to Government Contracts Regulations, should have been competitively tendered but were not. Exhibit 14.6 provides one example.

14.59 Regional distribution of contracts and contribution agreements. We obtained data from CIDA on the distribution, by province, of service contracts and contribution agreements over $100,000 in the Geographic Branches for the years 1997-98 and 1998-99. Exhibit 14.7 shows the regional distribution of service contracts for those years. Exhibit 14.8 shows the regional distribution of contribution agreements in the Geographic Branches for the same period.

CIDA has made efforts to make its selection process for competitive contracts fairer and more transparent.

14.60 CIDA has made efforts to make its selection process for competitive contracts fairer and more transparent. A key step was the move from a two-step process of prequalification and tendering to a one-step tendering process for competitive agreements. This new tendering process introduced clear policies on the necessity for competition. Upcoming projects and competitions are advertised on the government open bidding system. CIDA put a regional officer in Industry Canada's Vancouver office to encourage more Western participation and increase the pool of qualified contractors. A similar position is planned for Atlantic Canada. CIDA contracting personnel have also given presentations across the country to potential contractors.

Some errors occurred in the selection process for competitive agreements

14.61 Out of the 15 agreements in our sample that had used a competitive process, we found two with errors that had occurred in the selection process.

14.62 In one case, a contribution agreement for $4.1 million to train judges in China was awarded to the bidder with the highest score, a consortium of not-for-profit organizations. Three months after the winning bidder was notified, but before the agreement was signed, CIDA discovered that the winning bidder had made a $600,000 error in its calculations. The bid evaluation team had not found this error. Had the error been discovered

Exhibit 14.6

A Contract That Should Have Been Tendered Competitively But Was Not

The Miyun Reservoir Dam (the main reservoir for the city of Beijing, China) along with Canadian dam-monitoring equipment. The Miyun Reservoir Dam is one of ten dam sites that received monitoring equipment as part of the Dam Safety Monitoring and Management Project.

A sole-source contract for $6.4 million for a project in China was let in 1996 to a private sector company. CIDA received a preliminary proposal dated August 1994 for the design and implementation of this project. CIDA also received a letter of interest from a competitor, dated August 1994. A memo on file stated that it was "unlikely that CIDA policy would permit sole-source of either of the interested companies."

CIDA's Concept Paper stated, "the only major risk associated with this project is the sole-sourced selection of the Canadian executing agency for both design and implementation," and "other Canadian firms with equal or stronger overall capability, one of which was pursuing business in the same dam safety area, may protest the decision." This risk was mentioned again in the project approval document.

CIDA officially justified the sole-sourced selection of the contractor for the design phase under Government Contracts Regulations exemption 10.2.1 (d) "only one person or firm is capable of performing the contract." This justification was given to the Treasury Board despite the indications on file that there were equally or more qualified Canadian executing agencies. In its October 1995 submission to the Treasury Board, CIDA stated that the Canadian executing agency was uniquely qualified to deliver the project because it had "proprietary and unique rights of access" to a particular supporting technology necessary to deliver the project. For the execution phase of this project, CIDA prepared a new submission to the Treasury Board in June 1996 where it again justified sole-sourcing under the same exception and with the same explanation. CIDA files did not show how the particular technology for which the Canadian executing agency had proprietary rights was the only technology compatible or technically feasible for use in the project. On the contrary, discussions with CIDA project staff and notes on file indicated that there were other appropriate technologies available in Canada to other qualified firms. In our opinion, the sole-sourcing of this contract was contrary to Government Contracts Regulations.

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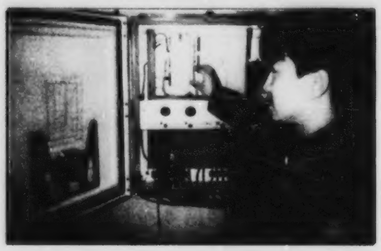

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and added to the bid price as normally required, a different consortium of not-for-profit organizations would have won the bid. Because the agreement had not yet been signed, CIDA still had an opportunity to re-evaluate the bids. CIDA wrote to the selected consortium and advised that it had two options. It could confirm the revised amount as calculated by CIDA, in which case the Agency would reassess its scoring, and this might have an impact on the evaluation result; or the consortium could withdraw its bid. These two options followed the government's normal bid evaluation practice. However, neither option was chosen and CIDA proceeded with negotiations with the selected consortium. Although the consortium asked for increased funding and a reduced level of effort to cover the error, CIDA refused and an agreement was eventually signed at the bid price. In our view, CIDA's treatment of this selection process was unfair to the consortium that was not selected.

14.63 In another case, a bidder who should have been disqualified was chosen (see the case study on page 14-22).

Exhibit 14.7

Regional Distribution of Service Contracts Over $100,000 in the Geographic Branches

Province/Region	Proposals	Number Selected	Dollar Value
Ontario	36%	36%	39%
Quebec	45%	36%	28%
West	15%	23%	26%
Atlantic	4%	5%	7%

Source: CIDA

Exhibit 14.8

Regional Distribution of Contribution Agreements Over $100,000 in the Geographic Branches

Province/Region	Percentage of contribution agreements signed	Percentage of contributions received by dollar value
Ontario	36%	36%
Quebec	24%	32%
Western Canada	13%	11%
Atlantic Canada	4%	2%
International Organizations	23%	19%

Source: CIDA

CIDA does not have a performance evaluation system for executing agencies

14.64 A performance evaluation system for contractors can serve to provide a record to be consulted during subsequent evaluations of tenders. While planning our audit, we looked at whether aid organizations in some other Western countries carried out performance evaluation of contractors. Our research showed that even where performance evaluation was mandatory, such as through legislation, project and program managers did not comply and only a low percentage of contractors were ever evaluated. The main reasons given were fear that public disclosure would lead to lawsuits against officials, and the workload required to carry out evaluations in a public context. For those reasons, CIDA has decided that it will not perform contractor evaluations and that each bid in response to a request for proposal will be evaluated on its own merits.

Execution

Agreements do not provide for management of assumptions deemed critical to project success

14.65 The development environment is one of considerable uncertainty. Every agreement is unique and every bilateral partner presents different challenges. As part of project management, CIDA managers of bilateral projects must identify assumptions at the planning stage that are critical to the project's success. The Canadian executing agencies are required to update the assumptions as part of their preparation of the project implementation plan. Some of these relate to external factors over which the Canadian executing agency would have no control (often the co-operation expected from the host country partner in terms of inputs); other assumptions, such as "equipment provided by the project is adequately maintained," could reasonably be addressed by the Canadian executing agency should the assumption be at risk.

14.66 We examined the agreements and their implementation to determine to what extent CIDA had identified critical assumptions. These can also be viewed as the areas of major risk that need to be managed for the project to be successful. We also examined whether the agreements assigned responsibility for tracking, reporting and resolving issues concerning those critical assumptions.

14.67 Our audit found that where reasonable, and as part of its development of a logical framework analysis, CIDA identified critical assumptions. This analysis is included in the project approval document and the request for proposal to suppliers. However, there was no specific requirement that suppliers describe in their proposals how critical assumptions were to be addressed. Nor did CIDA provide any guidance on how the responsibility for dealing with the critical assumptions would be allocated between CIDA and the Canadian executing agency. After initial identification of the critical assumptions, a framework would be useful to specify how they would be managed and who would be responsible for responding to situations where individual critical assumptions were not being met.

14.68 Only two of the agreements we examined provided for how the critical assumptions would be managed. We found that generally CIDA and its executing agencies have been slow or unable to take responsibility and react when critical assumptions fail to materialize and problems ensue. The case study on page 14-15 and the following case provide examples.

14.69 CIDA designed a project for Mali to improve its income tax system. An assumption it identified as critical to the project's success was that there would be political will and consistent support by the host government. It signed a contract with the Canadian executing agency in June

Generally, CIDA and its executing agencies have been slow or unable to take responsibility and react when critical assumptions fail to materialize and problems ensue.

A peer educator in Cameroon provides counselling on the prevention of AIDS and sexually transmitted diseases.

1997 for $13 million. When there were signs that the necessary conditions for tax reform were not in place and that local and Canadian personnel did not have the assumed expertise, neither the Canadian executing agency nor CIDA took any decisive action. Canadian executing agency personnel were kept in place and they worked on the activities that they could.

14.70 Some CIDA project officers expressed frustration that the Canadian executing agencies were "not doing their job." CIDA officers often rely on contracted monitors to provide them with independent assessments of executing agencies' progress. The monitors' reports we examined did not routinely address the continuing validity of the critical assumptions or identify new critical

Lack of Due Diligence in Selecting a Contractor for a $6.3 Million Contract

View of an electrical pole installed as part of a CIDA project to renovate and restore the electrical distribution system in Bamako, Mali.

This project involved the installation of hydro poles and equipment in Mali, with a component for training of local staff. At the time this contract was tendered, CIDA used the two-stage process for holding competitions. The first stage was an invitation to prequalify, and CIDA identified seven firms that met its criteria. For this project, the Minister prequalified three firms to receive a CIDA request for proposal. The second stage was the actual submission of contract proposals by the prequalified bidders.

We found two serious problems in the selection of the winning company, both at the prequalification phase:

- The first problem relates to the issue of Canadian ownership and effective control. Bidders invited to prequalify were advised that only those entities having their head office in Canada and having not less than 51 percent of all classes of shares beneficially owned and controlled by Canadian citizens or landed immigrants were eligible. When submitting its bid in September 1995, the company attested to meeting that condition and provided a letter from its auditors certifying to that effect.

However, after CIDA's Evaluation Review Board recommended the company as the winner on 26 June 1996, but before the contract was signed on 7 November 1997, one of the losing bidders complained to CIDA's Minister that the winner should have been declared ineligible. The complaint contended that the company was not Canadian-controlled at the time it submitted its bid for prequalification. To support its claim, the losing bidders' lawyers made reference to annual reports submitted to the Superintendent of Financial Institutions of Quebec that showed the company was owned and controlled by a French company at the time. These reports are publicly available, but CIDA staff told us they had not obtained them.

We obtained these reports. The report dated October 1995 (less than one month after the company's representation to CIDA that it was Canadian-owned and controlled) showed that there had been no change of ownership since the previous report. The previous report dated December 1994 showed a French company as the majority shareholder controlling the majority of votes.

CIDA files also referred to a Dun and Bradstreet report that was no longer on file. We then obtained directly from Dun and Bradstreet two reports, one dated September 1995, the other April 2000. The one dated 1995 showed a French parent company as the majority shareholder. The one dated April 2000 showed that the company had changed to Canadian control in 1997.

CIDA also had on file audited financial statements from the company as at 31 December 1995. These statements made reference to a loan from a parent company. While CIDA staff told us that they had relied on the letter from the company's auditors to support the decision to uphold its selection, they could not explain this apparently conflicting information. We requested that CIDA obtain an explanation of how the company selected could have been considered eligible in September 1995. Based on our examination of the documentation that CIDA subsequently received, in our opinion the company did not meet CIDA's conditions for beneficial ownership and effective control.

We believe that CIDA failed to show due diligence in following up the complaint. It ignored documentation it had on file that supported the complaint; it did not obtain explanations regarding the auditors' letter it relied on; and it did not seek out publicly available information that would have provided further evidence on the question.

- The second problem relates to the evaluation grid. All bidders at the prequalifying stage were provided with CIDA's evaluation criteria as part of the tender call. One requirement was that the bidders obtain a minimum score for relevant experience. The company in question did not obtain the minimum score, and thus should not have been selected for prequalification. CIDA did not disqualify the company. Normally, if criteria for selection must be changed, the bidding process is started over so that all potential bidders are on an equal footing.

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assumptions that would need to be realized for the project to succeed.

14.71 Some Canadian executing agencies told us that many of the assumptions (such as the provision of competent staff by the host country) are beyond their control. As well, their contracts do not require them to monitor and report on whether the critical assumptions continue to be valid.

14.72 Where appropriate, CIDA should incorporate into its agreements provisions that designate responsibility for monitoring, reporting and dealing with situations where critical assumptions are at increased risk of no longer being valid.

Agency's response: *CIDA will update its Geographic Programs Roadmap to better provide guidance to managers and reflect their responsibility for monitoring, reporting and dealing with situations where critical assumptions are at risk.*

Co-operation of the host country is key to successful performance and sustainability

14.73 In our 1998 audit, we described problems of control over the flow of money into counterpart funds. Our sample of 33 agreements for this audit included 6 agreements for items to be sold and the proceeds deposited in counterpart funds. The host country typically signs a memorandum of understanding (MOU) with Canada, guaranteeing the full deposit of the proceeds.

14.74 In two of the six agreements, the host country did not deposit the full amount owed to the counterpart fund, even though it had signed an MOU agreeing to do so.

14.75 In one case, in the fall of 1996 CIDA purchased $4 million of wheat for shipment to Egypt. The Egyptian government had agreed to deposit the full equivalent value in local currency of approximately 10 million Egyptian pounds into a special account to be used for development purposes. Our audit found that the Egyptian government deposited only 8 million Egyptian pounds (approximately $3.2 million) to the special account in July 1997. During our field visit, we observed that CIDA had never verified the amount deposited, as it was entitled to do. In the other case, which occurred in Mali, the problem was similar although the dollar amount was smaller.

14.76 CIDA should verify that agreed-upon amounts have been deposited to counterpart funds, and where they have not it should take appropriate action.

Agency's response: *CIDA will more consistently verify that all agreed-upon amounts have been deposited to counterpart funds and take appropriate action where needed.*

14.77 Projects in the Geographic Branches include the participation of the host government or one of its agencies in achieving the overall project results. This requires that CIDA's executing agency and the host country partner work closely together in harmony and that each fulfils its designed role in a responsible manner. The contribution of the host country partner to the project is defined in an MOU; however, not all countries have the same capacity or political will to fulfil their commitments in the MOU.

14.78 The Canadian executing agency normally cannot be held responsible for ensuring that the host country partner respects its obligations; nor can it be held responsible for overall project results where there are indications that the host country partner has not fulfilled its commitments. However, it can be made responsible for providing CIDA with information on the participation of the host country at the operational level.

14.79 About half the agreements we examined had difficulties related to the participation of the host country. In those

In two of six agreements in our sample, the host country did not deposit the full amount owed to the counterpart fund.

cases, CIDA's options were limited. Either the project continued without all the planned participation of the host country, or CIDA and its executing agency absorbed extra responsibility (for example, see the case study on page 14-15). In only one case was the project terminated due to unresolvable differences between CIDA and the host country agency. The decision was well founded and prevented considerable further expenditures on a project that was likely to be unsuccessful, but at a considerable cost of time, money and energy.

14.80 Although CIDA plans to spend a certain amount in a country each year, its officers must allow for the capacity of the host country partner when considering the size and complexity of projects being proposed. The difficulties we found relating to host country participation tended to be in large projects in least developed countries.

For projects in serious difficulty, CIDA does not normally cancel the agreements

14.81 Due to the nature of most development projects, as well as the complex logistics of getting Canadian staff on the ground, CIDA usually must pay contractors for the inputs they provide rather than for the outputs they achieve. At the same time, the agreements make the Canadian executing agency accountable for achieving the expected outputs. If the Canadian executing agency fails to do so, CIDA must either cancel the agreement or amend its scope.

14.82 To get a large project planned and approved, tendered, contracted and operationally planned can take anywhere from one to four or five years. It involves considerable expense and effort on the part of both CIDA and the host country partner. Given this large investment in resources and the short-term costs associated with cancellation, it is difficult for CIDA to decide to cancel the agreement when results are not forthcoming. CIDA does not build into its management of project agreements any formal requirement or mechanism for "off ramps" (decisions to proceed or withdraw).

14.83 In our sample of 33 agreements, 15 had a significant portion of deliverables that were not being met as planned. CIDA chose not to cancel 13 of these agreements, and cancelled 2 of them.

14.84 CIDA should build into its larger service agreements a provision for a formal review point, at which time a decision can be made on whether the project should be continued or cancelled or its scope changed. The procedures for doing this should be built into the agreements. (While the timing could vary, a logical point might be 12 to 18 months after CIDA's approval of the Project Implementation Plan.)

Agency's response: *CIDA had already started to do this for some of its larger service agreements. CIDA will now more systematically include the provision of a formal review point as part of the professional services agreement.*

Agreements are generally well monitored

CIDA staff attach considerable importance to monitoring projects under their responsibility.

14.85 We found that CIDA staff attach considerable importance to monitoring projects under their responsibility. They commonly use monitors under contract to review and report on the progress being made, and they insist on receiving periodic reports from the Canadian executing agencies as stipulated in the agreements. They also visit projects and attend on-site project steering committee meetings.

14.86 The quality of reporting by Canadian executing agencies continues to present difficulties for project officers. All the service agreements we examined contained clauses that required the Canadian executing agency to report on progress. Nevertheless, both CIDA and Canadian executing agencies expressed their frustration to us over expectations for these reports, and the time taken to produce them. Canadian executing agencies often produce the reports late, and it may take a few iterations to satisfy the CIDA project officer. Canadian executing agencies told us that CIDA does not specify clearly what it wants; however, CIDA officers told us they believe it is the Canadian executing agency's job to develop an appropriate report. In some cases, this problem resulted in projects being slowed because the CIDA officer did not have the necessary information to approve new work plans.

14.87 In May 1999, CIDA's Performance Review Branch issued a Guide to Project Performance Reporting for Canadian Partners and Executing Agencies. The guide, which is posted on CIDA's Web site, provides a template for results-based project reporting. It also explains how the monitoring of assumptions critical to a project's success should be integrated into the report and how financial and activity information should be presented. From the agreements we examined, this guide does not seem to be widely applied yet in the Geographic Branches.

The quality of annual project progress reports continues to be inconsistent

14.88 Each project officer in CIDA is required to prepare an annual project progress report (APPR) on each project. The report shows an overall assessment of the project's progress against plans, for both results achieved and amounts spent. This report has been the main internal method of accountability for results by project. It is also the basic document used for preparing CIDA's annual Performance Report to Parliament. In our 1998 audit of Geographic programs, we examined the quality of CIDA's APPRs and found that it varied widely.

14.89 We examined the APPRs in our sample for the year ended 1998-99. We found that in 6 of the 29 reports, some information did not realistically describe the actual status of the project. Most of the problems with the quality of the information related to the overall assessment of whether a project was reported as progressing satisfactorily, had "manageable problems" or had "serious problems". CIDA has not provided project officers or managers with guidance on how to interpret these terms.

Some information in the annual project progress reports did not realistically describe the actual status of projects.

Agreements need to better support results-based management

14.90 In order to support results-based management (RBM), agreements need to be managed with a high degree of professionalism:

- Expectations for results need to be clear and realistic.
- The capacity of the host country partner needs to be properly assessed.
- The sustainability of project benefits needs to be addressed in agreements where appropriate.
- Agreements need to be tendered competitively where applicable.
- Assumptions critical to a project's success need to be managed.
- Operational issues such as staff turnover and progress reporting need to be dealt with smoothly.

Our audit identified problems in the above-noted areas at the planning, selection and execution stages of the agreement process. When a combination of problems is present in a particular agreement, the effect is compounded and it becomes more difficult to obtain results.

14.91 When the proper elements of results-based management are in place, the chances are increased that an agreement will result in a successful project. One such example is the Women's Law project in China (see the case study on page 14-26).

14.92 As CIDA works on improving its management of contracts and contribution agreements, we believe it would be useful to consider a number of questions, such as the following:

- Should CIDA managers focus on identifying the development need and the results expected, letting bidders propose how they would design and manage a project to achieve the expected results?
- How can formal review points or "off ramps" be built into agreements so that projects less likely to achieve desired results can be terminated without great additional cost or loss of goodwill?

Canadian Partnership Branch Agreements

CIDA often does not receive key information for monitoring performance

14.93 The objective of the Canadian Partnership Branch (CPB) is to promote mutually beneficial partnerships between Canadian and developing country organizations in order to support sustainable development and reduce poverty in the developing world. CPB partners include a wide range of organizations: community, development and environmental organizations, universities, churches, professional associations and co-operatives.

14.94 Canadian Partnership Branch operations are delivered through four programs: Voluntary Sector, Industrial Co-operation, Scholarships and Awards, and Youth Internship. Our examination of the Branch focussed on the largest of its programs — the Voluntary Sector program. Organizations in the Voluntary Sector program are funded through either program or project funding. Program funding constitutes financial assistance, which is renewable and thereby enables an organization to undertake development initiatives on a broader, more continuous basis. Program agreements normally extend up to three years. Each program usually comprises a number of projects, ranging from a few to several hundred. Project funding provides support for a

Women's Law Project in China

One contribution agreement in our sample was signed to help Chinese women realize their rights under the 1992 Law of the People's Republic of China on Protection of Rights and Interest of Women. We found that this project incorporated most of the elements we would expect from a well-managed agreement.

Competitive process

CIDA worked with the All-China Women's Federation (ACWF) to develop the basic objectives and principles for the project into a concept paper. Both parties agreed in writing to these principles and objectives in December 1995. The project concept was incorporated into a request for proposal (RFP) package for a competitive contribution agreement outlining the project to be delivered by a consortium of not-for-profit organizations. The RFP was sent to eight potential lead organizations for the eventual consortium. Bids were received from three consortiums made up from all the eight. A team including the project manager, a contracting officer and a contracted expert on legal issues evaluated the bids. CIDA awarded the contribution to the consortium with the highest score.

Contribution agreement

The contribution agreement clearly outlined the project's objectives, expected results, project components, general activities, and responsibilities of the various project counterparts. The Canadian executing agency and the ACWF also signed a side agreement that outlined the financial and other obligations of each organization for the joint management of the project.

Sustainability

The project design and implementation paid attention to the four conditions of sustainability of benefits. The main Chinese counterpart, ACWF, was identified at the concept stage of the project. ACWF was involved in the planning and design of the project and is involved in the ongoing implementation of the project. ACWF's financial contribution to the project was outlined in the Project Management Plan and is tracked and reported in semi-annual reports to CIDA. Capacity building of ACWF project staff was built into the project to prepare the organization to take over the project activities once CIDA funding ends.

Project execution and reporting

The details included in the contribution agreement and the Project Management Plan have allowed the Canadian executing agency and ACWF to keep the project activities focussed on their objectives. The Project Management Plan outlined specific measurable results and key project milestones for each component. These project milestones have been tracked and refined in each semi-annual report to CIDA. In addition, a detailed Gantt chart is produced in the annual work plan for each activity. This detail has allowed the Canadian executing agency to make adjustments when delays occurred in one component or another. For example, when the information dissemination component was delayed, the Canadian executing agency was able to reallocate resources to the training component of the project.

14.92 As CIDA works on improving its management of contracts and contribution agreements, we believe it would be useful to consider a number of questions, such as the following:

- Should CIDA managers focus on identifying the development need and the results expected, letting bidders propose how they would design and manage a project to achieve the expected results?
- How can formal review points or "off ramps" be built into agreements so that projects less likely to achieve desired results can be terminated without great additional cost or loss of goodwill?

Canadian Partnership Branch Agreements

CIDA often does not receive key information for monitoring performance

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single non-renewable initiative for one to three years.

14.95 The Canadian Partnership Branch ensures the eligibility of the partner organizations that receive support and assesses the extent to which their programs reflect the Agency's programming priorities and objectives. The Branch is also responsible for assessing the financial and technical capabilities of partner organizations and for assessing progress toward achieving the program results sought. CIDA does not get involved in the day-to-day management of the partners' program and project activities. The Agency focusses its efforts toward managing its relationship with its program partners at the institutional level, rather than at the project level.

14.96 As part of this audit, we examined a sample of seven program agreements in the non-governmental organization division of the Voluntary Sector program. We selected agreements that had one or more projects in the six countries we visited. All the agreements selected were with organizations that had been CIDA partners for a number of years.

14.97 Our audit concentrated on how well the control framework of the Canadian Partnership Branch is working. We identified a number of key elements in the CPB control framework, including:

- grant and contribution agreements that call for CIDA's partners to provide interim financial reports, annual financial reports, and annual narrative reports;
- review of multi-year program proposals;
- annual review of financial health by the Financial Risk Assessment Unit;
- periodic institutional assessments; and
- ongoing dialogue and occasional site-visits with partners.

The Agency focusses its efforts toward managing its relationship with its program partners at the institutional level, rather than at the project level.

14.98 For the agreements we reviewed, financial reports as well as annual audited financial statements were generally submitted as required. The narrative reports submitted by partner organizations varied considerably in the quality of information provided. Two reports we reviewed clearly described the programs and projects that were funded and the amounts spent on them. The others provided little specific information in these key areas. In the absence of this information, the CPB cannot know or verify statements of results achieved. In addition, where results were indicated, they were not linked back to those expected. In an effort to improve reporting on results, in January 1999 CPB instructed its program officers that effective immediately all new proposals for funding renewal were to include a results-based management planning framework. In addition, a Guide to Performance Reporting for Canadian and Developing Country Partners was issued in February 2000.

CIDA's program partners had difficulty measuring the outcomes of their program activities.

14.99 We found that the annual financial risk assessment had been done in six of the seven cases we looked at. In the other case, the assessment done in the year previous to the agreement indicated a low risk. CIDA received audited financial statements for all seven program agreements. In our opinion, the financial risk assessments were effective in providing assurance to CIDA on the financial health of its partners.

14.100 The primary goal of the periodic institutional assessment is to provide an overview of the organization, specifically related to issues of management and administration. The terms of reference of the institutional assessments do not require an assessment of the organization's efficiency and effectiveness in obtaining development results. However, the assessments we reviewed noted that CIDA's program partners had difficulty measuring the outcomes of their program activities. In many cases, this inability resulted from an absence of baseline data. As a result, the institutional assessments provide CIDA with limited information on whether its partners are delivering effective programming.

A Malian woman using a CIDA-financed mill. Before, this operation was performed manually and required much more time and effort.

14.101 Institutional assessments are essentially a review of the organization, which are agreed upon jointly and carried out by an independent third party. They are normally conducted when a program renewal is due. CPB managers are accountable under CIDA policy for assessing the capacity of recipients to deliver aid. However, institutional assessments were not carried out in two of the seven cases prior to their program renewal. For the five program agreements that had institutional assessments, there was evidence that recommendations were being followed up by the partner organizations.

14.102 We noted that CPB officers are required to review each program proposal before recommending a funding renewal. These reviews include the program officer's assessment of the performance of the institution over the past one to three years. However, in the agreements we reviewed, with one exception the funding approved by the Minister from 1996-97 to 1998-99 was based on historical levels less any across-the-board cuts as a result of government spending restraint. In the one exception, the partner's funding was reduced as a result of CIDA's performance assessment.

14.103 We also noted that for 1998-99, the Minister approved across-the-board cuts in funds to most CPB partners, but provided increases to 5 out of 27 organizations as a result of CIDA performance assessments.

14.104 For the agreements we examined, CIDA's control framework provides it with reasonable information on the financial health of its partners. However, CIDA receives only limited information on development results at the program and project level. As noted in paragraph 14.100, CIDA's institutional assessments commented on the limited ability of partners to provide performance information relating to the outcomes of their programs.

14.105 The Canadian Partnership Branch should continue its efforts to obtain better performance information from its partners on the use of funds contributed by CIDA and development results achieved.

Agency's response: *The Canadian Partnership Branch has recently developed "A Guide to Reporting" for its partners, which provides guidance on the nature and scope of performance and financial information required by CIDA.*

More meaningful and accurate information is needed on the Canadian Partnership Branch in the Performance Report to Parliament

14.106 As part of our audit, we reviewed the performance information on Canadian Partnership Branch activities provided to Parliament in CIDA's 1998-99 Performance Report. Our observations are similar to those we made in 1998 on the Geographic programs' information in CIDA's Performance Report. The CPB information in the Performance Report provides examples of achievements without any context on expected results or resources expended to achieve them. Where the examples span a number of years, the number of years is not indicated.

14.107 We also reviewed two specific items of information in the Performance Report to assess their accuracy.

- The Report indicated that for every $1 contributed by the CPB to the Voluntary Sector program in 1998-99, an average of $1.19 in funds was contributed by partner organizations. Based on our review, a better presentation of CIDA's contribution relative to that of its partners would have been closer to $1 for every $0.57.

- The Report also indicated that 85 percent of CPB's programs and projects were likely to meet or exceed planned results. CIDA based this estimate on results ratings provided by Voluntary Sector program officers. We noted some concerns about the quality of the information that officers relied on in their estimates. For example, four based their estimate of progress on the amount of budget spent. Based on our review of the documentation for the seven program agreements we audited, we could agree with only one of the results ratings provided by the program officers. This leads us to conclude that the figure of 85 percent was overstated.

14.108 CIDA should improve the completeness and accuracy of the information on the Canadian Partnership Branch in its Performance Report.

Agency's response: *The Canadian Partnership Branch will continue to improve indicators and statistics given in the Performance Report to ensure that they are more meaningful and useful for the reader. The training offered to, and the experience gained by, Canadian Partnership Branch staff in results-based management will over time improve the quality of the reporting on results being achieved.*

Gaps in CIDA's New Information System

14.109 As part of implementing its new Enterprise Resource Planning (ERP) integrated management information system, CIDA developed a module called "RBM tool". Project officers regularly input into this module the project information that currently goes into the Annual Project Progress Report. This module represents an improvement; although the information it contains is essentially narrative, it automatically integrates information from the financial module on total project spending to date. The new module also permits easier compilation of aggregate reports by data field — for example, a report listing all projects with serious problems and a narrative description of the problem. The module is useful for senior management review and for capturing a global view of a project's progress.

The introduction of the Enterprise Reporting Package (ERP) system and the "RBM tool" module has so far not achieved the integration of financial, contract and performance data at the project management level.

14.110 However, the introduction of the ERP system and the RBM tool module has so far not achieved the integration of financial, contract and performance data at the project management level. To properly manage agreements, project officers require information to monitor the details of outputs and activities against agreed-upon work plans. They also need to be able to match data on project spending with other data on outputs provided by executing agencies or monitors. An example of this type of project reporting was provided in CIDA's 1999 Guide to Project Performance Reporting: For Canadian Partners and Executing Agencies.

14.111 Out of its total information technology budget of $32 million for 2000-2001, CIDA has allocated $18 million to further develop its ERP system. Although there is reference in the planning documents to the RBM tool module, it has not yet been decided how the funding will be used. At this time, it is not clear whether the system improvements will provide project officers with detailed data on project activities and results relative to work plans, and be able to relate these data to spending at this level of detail. For instance, the software has the capacity to accommodate a reporting format under which Canadian executing agencies could submit performance information electronically to CIDA project managers for their input to the system. However, CIDA has no specific plans to develop this type of reporting format.

Some Compliance Problems in Contracts Under $100,000

14.112 For the years 1996-97 to 1998-99, CIDA entered into about 6,100 agreements; 5,300 of these were under $100,000 and reflected about 10 percent of the total dollar value of all agreements. Of the agreements under $100,000, about three quarters had an original value of under $25,000, which is the threshold above which a competition is normally required. Fewer than 200 of those were amended to more than $25,000.

14.113 **Some contract splitting occurred.** We focussed on the approximately 1,500 agreements between $25,000 and $100,000. We looked for possible cases of contract splitting. This occurs when an organization splits a larger contract into smaller contracts, thereby circumventing contracting regulations or policies. We analyzed a variety of possible indicators, such as more than one contract awarded to the same supplier with overlapping or concurrent dates, or several contracts awarded to the same supplier for the same amount. We then selected for further examination 13 service contracts issued to four companies from 1996-97 to 1998-99. We concluded that contract splitting avoided NAFTA tendering requirements in 9 of the 13 cases (see Exhibit 14.9 for an example).

14.114 **Non-compliance with contracting policy regarding former public servants.** In the course of our audit, we became aware that CIDA had entered into 10 non-competitive contracts with former public servants who were receiving a pension. These contracts contravened CIDA's delegated authority because the Agency did not obtain prior Treasury Board approval, as required for contracts with former public servants who were receiving a pension if the contract is non-competitive and its value exceeds $25,000.

14.115 In the fall of 1999, CIDA discovered two cases that contravened its delegated authority. To its credit, CIDA then examined its database of approximately 3,000 contracts and requisitions entered into with individuals since April 1997. CIDA's examination was made more difficult because there was no central or departmental registry that identified former public servants who were receiving a pension or had received a retirement incentive package. CIDA relied on the collective memory of its Human Resources and Corporate Services Branch staff to identify former such CIDA employees who had received a subsequent CIDA contract. However, this collective memory could not be extended to consistently identify former public servants from other departments who had received contracts from CIDA. From this examination, CIDA compiled a list of 114 of its former employees whose files it then included in preparing the information for submission to the Treasury Board. A total of 10 cases were identified. Three contracts dealing with a single Corporate Services (non-aid) issue are still active, with a total value of $886,000.

14.116 Because issues such as non-competitive contracting, compliance with authorities and due diligence were of particular interest to us in this audit, we examined how this situation arose in the first place. We also examined the adequacy of the actions taken to obtain retroactive Treasury Board approval of these contracts and to ensure that the problem does not happen again.

14.117 We paid particular attention to the three contracts that remain active. In addition to the compliance issue identified by CIDA, we have some further concerns:

- We noted that one company had previously obtained four other non-competitive contracts for the services of the same individual. One of these, for $46,700, also exceeded CIDA's authority but was not included in the Treasury Board submission for authorization of retroactive contracts.
- There was little information to support the fees arrived at. In two cases, CIDA accepted the statement that the fee amount matched what a private sector client would pay. However, there was no documentation on file indicating the fees that had been charged to others. In the third case, the program officer authorized more than recommended by CIDA's Contracting Management Division; this was done on the basis that had the former employee not retired, the employee likely would have had a promotion in the intervening period and should, therefore, be paid at a higher rate.
- In our view, the documentation in these files did not adequately justify an exception from the Government Contracts Regulations to enter into non-competitive contracts.

14.118 CIDA has since taken measures to prevent a recurrence of the problem. Among other measures, it has issued a bulletin to all staff reminding them of the policy on contracting with former public servants. It has also reminded staff of the requirement for a declaration form to be completed by an individual or a firm, indicating whether the individual is a former public servant in receipt of a pension. This declaration is to be

Exhibit 14.9

Contract Splitting Avoided North American Free Trade Agreement (NAFTA) Requirements

CIDA's continuous learning division required consultative services to assist in the delivery of informatics training on the software packages available to staff. In April 1996, six companies were invited to send in proposals to provide individuals to deliver the training. One company won the bid to provide the services of two individuals for a one-year period at $128,400. CIDA split the winning bid into two separate contracts of $64,200 each. Each contract was extended to 31 March 1998 and the contract amounts were amended by adding $58,315 each. In April 1998, five companies were invited to send in proposals to continue providing this training. The same company again won the bid to provide the services of two individuals for a one-year period at $123,264. Again, the winning bid was split into two separate contracts of $61,632. Each contract was extended to 31 March 2000, and the contract amounts increased through amendment by $57,673 and $47,187 respectively. Our audit found that the combined contracts exceeded the NAFTA thresholds in both 1996 ($70,700) and 1998 ($80,900). CIDA's contracting staff had also reviewed the 1998 contracts and concluded that their issuance failed to meet NAFTA requirements.

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maintained in the contracts file and a copy kept centrally with Contracting Management Division.

CIDA generally complied with Government Contracts Regulations and Treasury Board contracting policy in its contracting processes but often varied from its own internal policies or guidelines with respect to contribution agreements

14.119 We believe that CIDA also needs to seek Treasury Board approval for the overlooked contract that exceeded $25,000.

14.120 The actions taken by CIDA should serve to keep this situation from recurring — but only if policy requirements are respected.

Conclusion

14.121 CIDA generally complied with Government Contracts Regulations and Treasury Board Contracting Policy in its contracting processes. However, the terms and conditions governing the use of contribution agreements are very general and permit CIDA to make exceptions to its regular procedures. CIDA varied from its internal policies or guidelines by often using contribution agreements instead of competitive contracts for projects that were not unsolicited proposals but were initiated by CIDA. This also raises questions on the fairness and transparency of the process used by CIDA in selecting executing agencies for its larger projects.

14.122 CIDA's processes for entering into contracts and contribution agreements are not yet providing sufficient support for results-based management. In many instances, these agreements do not meet CIDA's operational requirements. They contain unclear or unrealistic expected results, or do not provide for monitoring of and action on changes to assumptions that are critical to project success.

14.123 The control framework for the non-governmental organization division of the Voluntary Sector program in the Canadian Partnership Branch provides reasonable information on the financial health of CIDA's partners. However, there was limited information on the projects funded and results achieved. The quality of information on the Canadian Partnership Branch in CIDA's Performance Report to Parliament needs to be improved.

About the Audit

Objectives

Our objectives in this audit were to assess whether CIDA's contracting/contribution processes:

- respect Government Contracts Regulations, Treasury Board guidelines and its own policies;
- are fair and transparent; and
- meet operational requirements and development needs.

Scope and Approach

This audit focussed on how CIDA Geographic Branches (excluding the Central and Eastern Europe Branch) manage contracts, contribution agreements and other types of agreements for goods and services, including the selection of Canadian executing agencies to deliver projects.

The audit also examined the control framework for agreements in the Voluntary Sector program of the Canadian Partnership Branch.

We conducted our work at CIDA's headquarters and visited the selected projects in the field. We reviewed project documentation and held discussions with the local counterparts for the selected projects, and with Canadian executing agencies and CIDA officials.

Contracts and contribution agreements population

Since CIDA uses contracts, contributions and other types of agreements for the same purposes and manages them all in a similar fashion, we included all these types of agreements in our sampling plan.

In selecting a population of agreements to test from, we wanted to include both agreements that had taken place before the Open Competition Pilot Project as well as those made after. We included in our population contracts and contribution agreements signed in the Geographic Branches, as well as grants and contributions signed in the Canadian Partnership Branch, for the three-year period from 1 April 1996 to 31 March 1999.

Sampling plan

In the Geographic Branches, agreements with a value of over $100,000 account for over 90 percent of the total value of all agreements. To carry out our audit, we developed a dollar-unit statistical sampling plan that involved examining $1.8 billion of Geographic Branches agreements and $600 million of Canadian Partnership Branch agreements signed in the years 1996-97 to 1998-99. This resulted in the selection of 33 Geographic Branches agreements with a total value of $214 million, and 7 Canadian Partnership Branch agreements, in six chosen countries. The countries chosen were India and China for Asia, Peru for the Americas, and Egypt, Cameroon and Mali for Africa and the Middle East. The selection of countries reflected the dollar importance of each region and discussions with CIDA.

In order to test the continued relevance of our findings, we also randomly selected for examination a separate small sample of agreements signed in the 1999-2000 year, for which we did not perform field visits.

Criteria

Our main sources of criteria were previous audits of the Office of the Auditor General, Treasury Board directives and CIDA guidelines.

a. General criteria

- Government Contracts Regulations, and Treasury Board and CIDA policies should be respected.
- For contribution agreements and sole-source contracts, review and control of selection of suppliers, negotiation of arrangements, drafting of terms and monitoring should be at least as rigorous as for competitive contracts.
- Where possible, contribution agreements and contracts should reflect results-based management principles, policy and framework in all possible respects.
- Information from performance monitoring reports and reviews should be used as required for management decision making and taking corrective action on projects.

b. Criteria related to the contracting/contribution agreement process

Planning

- The contracting plan should contain an analysis of different options for the particular project, with competition being the norm. For the non-competitive options, the choice should be well documented and in line with Treasury Board approvals and contracting policy.

Design

- The statement of work should be clear enough to be translated into contract deliverables.
- Recipient country and counterpart fund contract plans should respect government and CIDA contracting goals of probity, fairness and transparency.

Selection

- The contract team should have sufficient technical knowledge to develop a detailed evaluation grid and to use the grid to evaluate the proposals.
- The evaluation grid should be sufficiently detailed so that the weights assigned to each item being ranked are shown.
- The evaluation grid should be consistent with the Terms of Reference.
- The evaluation of the project proposal should address the contractor's approach to managing inherent and external project risks.

Execution and monitoring

- Project implementation plans should be consistent with the statement of work in the contract and the project approval document and also show the steps and milestones to achieve results.
- Contract performance should be monitored and evaluated against the terms and conditions of the contract. Contractual remedies for substandard performance should be applied.
- Project and contract files should follow a standard format and be well maintained.

Performance reporting

- Annual project progress reports should be an accurate representation of the project status and results.

Environment

- Where there is an element (goods or physical work) of the project that could affect the environment, an environmental assessment should be completed to determine environmental effects.

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Chapter 15
Health Canada – First Nations Health: Follow-up

October 2000

This October 2000 Report comprises 8 chapters as well as a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Copies françaises aussi disponibles

Chapter 15

Health Canada

First Nations Health: Follow-up

The follow-up work was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Few of the required on-site audits of providers have been completed 15-22
Other problems with claims-processing contract 15-22
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Limited progress made to improve efficiencies in medical transportation 15-24
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First Nations Health – Follow-up: Overall Assessment of Progress Made 15-30

Health Canada

First Nations Health: Follow-up

Main Points

15.1 Health Canada has initiated action to address our observations and recommendations on First Nations Health (1997 Report, Chapter 13). However, we are concerned that the Department has not yet made sufficient progress to fix many of the problems we identified. Continued and sustained effort is required to ensure that all the recommendations are fully implemented.

15.2 We found that:

- the point-of-service system, a key mechanism in the administration of pharmacy benefits and the control of prescription drug use, is now fully operational. It provides drug utilization warning messages to assist pharmacists in deciding whether to dispense prescriptions. As a result, a number of prescriptions have not been filled; and
- a pre-determination process for dental benefits, implemented nationally since 1997, has resulted in substantial savings.

15.3 However, we observed that:

- the management of contribution agreements for the delivery of community health programs is still weak;
- the management of transfer agreements still needs improvement; and
- Health Canada has not adequately monitored the drug utilization warning messages that pharmacists have overridden. Nor has it undertaken sufficient analysis of the effectiveness of the messages to determine whether any adjustments are warranted.

Background and other observations

15.4 Health Canada delivers health services and other related services to over 600 First Nations communities. It delivers them mainly through community health programs (including those transferred to community control) and the Non-Insured Health Benefits program, which covers such benefits as prescription drugs, dental care, medical transportation, and other benefits. Together, these services represented spending of just over $1.0 billion in 1998-99.

15.5 Our 1997 audit found that Non-Insured Health Benefits program expenditures were not well managed and, in most areas, not properly controlled. In particular, significant weaknesses in the management of pharmacy benefits allowed clients to access extremely high levels of prescription drugs. We noted numerous reports of prescription drug addiction and prescription-drug-related deaths of First Nations individuals in several provinces. We also found weaknesses in the management of contribution agreements for the delivery of community health programs as well as in the management of transfer agreements.

15.6 Our follow-up found that the Department has made limited progress in ensuring that reports required under separate contribution agreements are provided. We also found that the Department's performance reports contain limited information on the status of community health programs, including outcomes achieved.

15.7 With respect to transfer agreements, we found that community health plans are still not being updated when agreements are renewed, and requirements for audits, annual reports and evaluations often are not met.

15.8 The Department developed and implemented a protocol for following up with clients, physicians, pharmacists and professional bodies on cases that suggest possible prescription drug misuse. This has had some positive impact, with some regions starting to show a decline in the number of cases of individuals accessing large amounts of prescription drugs. However, as management was unsure of the appropriateness of the approach in the absence of either client consent or specific statutory authority for the Non-Insured Health Benefits program, this intervention was stopped in May 1999. There are still cases of program clients accessing large amounts of prescription drugs, and these require follow-up.

15.9 The Department was slow to develop and incorporate an audit strategy based on an appropriate assessment of risks in its new pharmacy and dental claims-processing contract. It also failed to ensure that the contractor perform the on-site audits of pharmacies and dental providers that the contract requires. We found few such audits undertaken since December 1998 to provide assurance that expenditures claimed had been incurred for the intended purposes.

15.10 Progress to improve efficiencies in administering medical transportation benefits has been limited.

Health Canada's responses to our recommendations are included in this chapter. The Department is continuing with corrective action in response to our 1997 recommendations and has agreed to take action in response to our two new recommendations.

Introduction

15.11 In 1997 we examined the way Health Canada managed the health programs it delivered to First Nations and Inuit people. This chapter follows up on the Department's progress in correcting the weaknesses we had identified.

15.12 There are significant differences in health status between the First Nations population and the Canadian population overall. *Toward a Healthy Future: Second Report on the Health of Canadians*, published in 1999 by the Federal, Provincial and Territorial Advisory Committee on Population Health, notes that the First Nations population compares poorly with that of the Canadian population along several indicators (see Exhibit 15.1). The *Report of the Royal Commission on Aboriginal Peoples* observed that health problems are many, serious and persistent, and that whatever diseases and problems are plaguing Canadians generally are likely to be more serious among Aboriginal people. The Canadian Institute for Health Information notes in *Health Care in Canada 2000: A First Annual Report* that Aboriginal people have life expectancies significantly shorter than those of the total Canadian population. It states that this large difference probably reflects the fact that the Aboriginal population is disproportionately more likely to be unemployed, less educated, poorly housed and living in poverty.

15.13 At March 1999, there were approximately 672,000 status (or registered) Indians and recognized Inuit in Canada. This represents about two percent of the Canadian population. The First Nations population is growing by three percent annually — more than double the growth rate in the general population. This population growth is exerting significant pressure on the present infrastructure for delivering services. Other pressures on the delivery of health services to First Nations include rising drug costs, high incidence among First Nations of some chronic diseases such as diabetes and cardiovascular diseases, a shortage of nurses, and provincial health care reforms.

Delivery of health services to First Nations still presents considerable challenges

15.14 A number of governments deliver health services to the First Nations population — provincial and territorial governments, the federal government through Health Canada, and First Nations local governments. Some provinces have included First Nations in programs beyond the provision of basic health services, while others have not. As we reported in 1997, the federal government maintains that it provides health services to status Indians and recognized Inuit as a matter of policy and not under treaty or other legal obligations. However, most First Nations generally consider that all necessary health services must be provided to them under Aboriginal and treaty rights and, as such, represent a fiduciary obligation owed to them by the Crown.

15.15 Health Canada's First Nations and Inuit Health Branch (formerly Medical Services Branch) delivers health services to over 600 First Nations communities. The Branch has a staff

Exhibit 15.1

Selected Indicators of First Nations Health Status

- **The infant mortality rate is twice as high among First Nations people as in the Canadian population as a whole.**
- **The life expectancy of the status Indian population is seven years less than that of the overall Canadian population.**
- **Suicide rates among Aboriginal groups have been reported at two to seven times higher than in the population at large.**
- **The prevalence of all self-reported major chronic disease is significantly higher in Aboriginal communities than in the general population, and it appears to be increasing.**

Source: Toward a Healthy Future: Second Report on the Health of Canadians, 1999.

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complement of just under 1,400 full-time equivalents, headed by an assistant deputy minister. There are three main directorates at headquarters in Ottawa (First Nations and Inuit Health Programs; Program Policy, Transfer Secretariat and Planning; and Non-Insured Health Benefits) and seven regional offices (Atlantic, Quebec, Ontario, Manitoba, Saskatchewan, Alberta and Pacific).

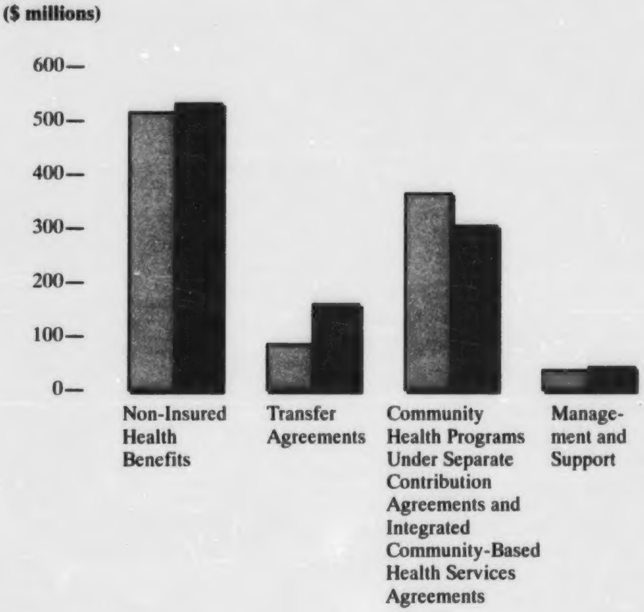
15.16 The Branch vision statement says that First Nations and Inuit people will have autonomy and control of their health programs and resources within a time frame to be determined in consultation with First Nations and Inuit people. The Branch objective is to assist First Nations and Inuit communities in addressing health inequalities and disease threats and attaining a level of health comparable with that of other Canadians living in similar locations, and to ensure the availability of, or access to, health services. The health services are provided mainly through community health programs (including those transferred to community control) and the Non-Insured Health Benefits program, which covers the costs of prescription drugs, dental care, medical transportation and other benefits. Total spending on these services was just over $1.0 billion in 1998-99 (Exhibit 15.2).

15.17 Community health programs delivered through separate contribution agreements and through transfer agreements. Community health programs comprise programs and activities related to public health, health education and promotion, as well as strategies to address specific health problems such as alcohol and drug abuse.

15.18 The mechanisms for delivery of community health programs have changed over time. Initially, these programs were delivered directly by the Department. Most programs are now delivered through arrangements in partnership with First Nations organizations. The Department uses three basic types of agreements that give First Nations varying degrees of flexibility, control and responsibility to design programs. In order of increasing flexibility, these are separate contribution agreements, integrated community-based

Exhibit 15.2

Expenditures on Health Services to First Nations, 1995-96 and 1998-99



Source: Health Canada, First Nations and Inuit Health Branch health services agreements and transfer agreements.

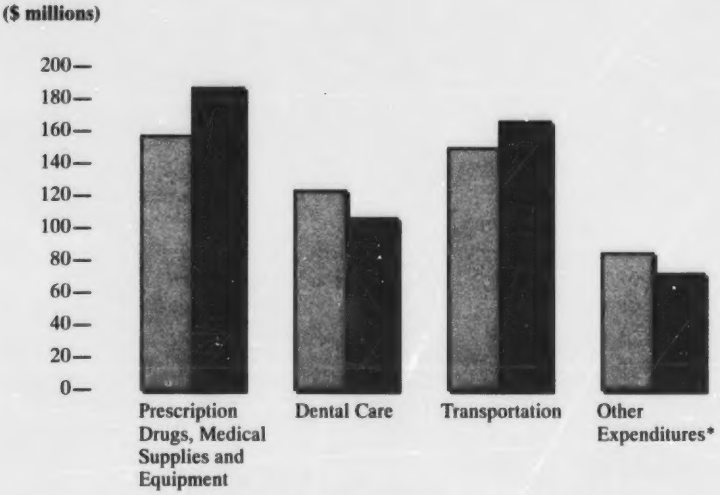
15.19 More and more First Nations are managing their own health programs under transfer agreements. The current trend in Health Canada is to continue this devolution and to move out of direct delivery of health services. In March 1997 about 27 percent of First Nations had signed a transfer agreement; by October 1999 this had risen to 44 percent of First Nations. The percentage of First Nations with contribution agreements showed a corresponding decrease — from 60 percent to 37 percent. There were integrated agreements with 13 percent of First Nations in 1997, and with 19 percent in 1999. In 1998-99, spending on community health programs through agreements totalled about $464 million (Exhibit 15.2).

15.20 Non-insured health benefits. The Non-Insured Health Benefits program covers a number of health-related benefits and services such as pharmacy, dental, medical transportation and other benefits. The purpose of the program is "to provide non-insured health benefits to First Nations and Inuit people in a manner that is appropriate to their unique health needs; contributes to the achievement of an overall health status for First Nations and Inuit people that is comparable with that of the Canadian population as a whole; is sustainable from a fiscal and benefit management perspective; and facilitates First Nations and Inuit control at a time and pace of their choosing." In 1998-99, Non-Insured Health Benefits expenditures totalled almost $532 million (see Exhibit 15.3).

15.21 In keeping with the federal government's commitment to a new relationship with First Nations and Inuit, the Department has embarked on a partnership approach with First Nations and Inuit in decision making on new program initiatives, funding, and program changes. The Department believes that this approach helps to enhance capacity among the First Nations and Inuit participants and helps ensure that their positions are reflected in the final decisions.

Exhibit 15.3

Expenditures on Non-Insured Health Benefits, 1995-96 and 1998-99



1995-96 — $515.6 million ☐

1998-99 — $531.7 million ■

* These include health premiums, vision benefits, other health care, and management and support.

Source: Health Canada, First Nations and Inuit Health Branch

Departmental commitment to improve

In 1997 we made 12 recommendations; the Department agreed with them and committed to taking corrective action.

15.22 In 1997 we identified weaknesses in the management of community health programs delivered through separate contribution agreements, the transfer of health programs to community control, and non-insured health benefits. We made 12 recommendations; the Department agreed with them and committed to taking corrective action.

15.23 The Standing Committee on Public Accounts held a hearing in late 1997 to discuss our audit. The Committee stated that it was anxious that the Department fulfil its commitment to take timely and complete corrective action and that the changes result in better management of health services and improved health for First Nations. The Committee made 10 recommendations in its Fifth Report, tabled in February 1998. In its July 1998 response to the Committee, Health Canada indicated that it was committed to continuous improvement in the effectiveness and efficiency of health programs for First Nations and Inuit. It provided an updated action plan in response to the Committee's recommendations.

The lack of timely and complete implementation of corrective action has serious implications for the delivery of health services to First Nations.

Focus of the follow-up

15.24 The follow-up focussed on our 1997 recommendations and on those made subsequently by the Public Accounts Committee. We looked at the Department's commitments and its actions taken in response to our 1997 audit, including the progress it reported to the Public Accounts Committee and the updated status report it provided to us in 1999. We also looked at several new initiatives that are being delivered using funding mechanisms similar to those of other community health programs. Further details on the follow-up are found in **About the Follow-up** at the end of this chapter.

Observations and Recommendations

Health Canada has not made sufficient progress to correct deficiencies

15.25 The Department has initiated action to respond to our observations and recommendations. However, we are concerned that the Department has not yet made sufficient progress to fix many of the problems we identified in 1997. The lack of timely and complete implementation of corrective action has serious implications for the delivery of health services to First Nations. Our overall assessment of progress made by the Department is summarized in the Appendix.

Community Health Programs Delivered Through Separate Contribution Agreements

15.26 In 1997 we found that the Department's management of separate contribution agreements was weak. The required reports on community health programs were not being produced and the Department was doing little follow-up with First Nations to build capacity. We recommended that it review the structure of community health programs, clarify program objectives, ensure that it received the required reports, and work with First Nations to improve their reporting to include information on results achieved. The Public Accounts Committee recommended that the Department monitor community health programs in accordance with departmental policies, supported by thorough evaluation of risk and targeted accordingly. The Committee also recommended that in its annual departmental performance reports Health Canada provide information on the status of community health programs, including information on its monitoring activities and on health outcomes achieved. The

Department agreed with the recommendations.

15.27 The Department committed to take steps to reduce program overlap. It indicated that it would develop guidelines to ensure that agreements have clearly defined objectives and activities to be undertaken. It stated that it would ensure that it received annual reports and would review all reports to identify any corrective action necessary. It also stated that it would implement new mechanisms, such as the automated contribution system, to improve the monitoring of activity reporting.

Continuous and sustained effort is required to fully implement our recommendations

15.28 Overlapping of programs. Health Canada has made changes to its Planning, Reporting and Accountability Structure, but the authorities for programs delivered under contribution agreements are unchanged. Our follow-up review of documentation for 35 contribution agreements found that there is still some overlap between program objectives. The Department has initiated a project that will identify specific objectives for each program, and it believes this will alleviate the overlap of program objectives. Objectives will be refined and the manner in which programs are delivered will change, as core objectives and programs are redefined. This project has the potential to reduce overlap of program objectives. However, at the time of our audit this work had not been completed and overlap continued to exist. The Branch will need to ensure that once the project is completed, these new objectives are reflected in contribution agreements.

15.29 Health Canada should ensure that its program structure reflects the manner in which community health programs are actually delivered.

Department's response: *Agreed. The program structure was changed to better reflect how programs are delivered. It provides the flexibility for reallocation of program dollars to other health areas of greater need. Work will continue to refine and further define the core (mandatory) and the discretionary programs under the program structure and program transfer initiative in order to facilitate a clearer understanding of the program structure. This is being done in partnership with First Nations and Inuit.*

15.30 Clear objectives and activities. Our follow-up found that the Department has been working with some First Nations to encourage them to clearly define program objectives and measures of success, with departmental staff working directly with these First Nations on specific programs. Our review of 35 contribution agreements, however, found that in over half of the cases, programs still do not include clear objectives and activities specific to the community (Exhibit 15.4). In many cases, contribution agreements gave no indication of how the community would know whether the activities were successful. As well, the Department has not yet developed formal guidelines to assist First Nations in ensuring that agreements include clear objectives.

15.31 Health Canada should continue to work with First Nations to ensure that the contribution agreements are clear about specific objectives and activities that First Nations will undertake. It should continue its efforts to encourage First Nations to define measures of success.

Department's response: *Agreed. The Department is developing a program compendium that will identify, for each program area, the objectives, program reporting requirements and program indicators. Once finalized, the compendium will form the basis for objectives and activities of contribution agreements. This work is being done in partnership with First Nations and Inuit.*

We found some encouraging improvement in the provision of activity reports required under contribution agreements.

15.32 **Activity reports.** We found some encouraging improvement in the provision of activity reports required under contribution agreements (Exhibit 15.4). In 1997 we found in a sample of contribution agreements we examined that the Department had received 33 percent of the required activity reports. Our follow-up review of 35 contribution agreements found that the Department now has 51 percent of required activity reports. However, this improvement is largely due to improved reporting on the Brighter Futures program — activity reports were provided for 71 percent of agreements, up from 32 percent in 1997. There is still some distance to go before all the required activity reports are completed for all programs. The success we noted in the Brighter Futures program needs to be carried over to other programs. We also noted that Health Canada has worked with some First Nations to ensure that activity reports provide information on results, but mostly the reports are still lists of activities undertaken. More Branch support is needed to build First Nations' capacity to meet their reporting requirements under these agreements. In addition, the Branch recognizes the need for systematic follow-up to ensure that the agreements are monitored.

15.33 Health Canada should ensure that it receives all the activity reports required under contribution agreements. It should work closely with First Nations to improve the activity reports so that they provide information on results achieved.

Department's response: *Agreed. The Department is actively working with First Nations to develop and implement tools to improve program reporting and completion rates. At the same time, the Department will continue to work with First Nations to find ways of developing the capacity to ensure that all communities are able to use the reporting tools and the data being reported and are capable of analyzing the impact of activities on community health programs. Monitoring and follow-up requirements will be incorporated in the planned automation of the national contribution system to regulate the receipt of activity reports.*

Exhibit 15.4

Assessment of Contribution Agreements

Program	Agreements with clear objectives and activities for the specific community		Agreements with activity reports	
	1997 Audit	2000 Follow-up	1997 Audit	2000 Follow-up
Community Health Representatives	15%	28%	39%	41%
National Native Alcohol and Drug Abuse Program	19%	28%	32%	44%
Brighter Futures	59%	61%	32%	71%
Building Healthy Communities	59%	50%	27%	48%
For all programs	**38%**	**42%**	**33%**	**51%**

Note: 1997 observations based on analysis of contribution agreements from 40 communities; 2000 observations based on analysis of contribution agreements from 35 communities.

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Management of contribution agreements is still weak

15.34 We expected that the Department would have taken steps to improve its management of contribution agreements. Our follow-up found that the Department's monitoring of reporting requirements remains weak. The proposed automated contribution system, which the Department had indicated would improve its monitoring of reporting requirements by tracking whether reports were provided, is operational in only two regions. The Department recognizes that it must give more attention to providing support to help First Nations improve their capacity to meet reporting requirements under contribution agreements.

15.35 The Department's internal audits of contributions have confirmed the need for improved reporting. In some cases, these audits have also observed the need to ensure that program policies and objectives are respected and that expenditures meet program terms and conditions.

15.36 There are indications that the Department has become more proactive in monitoring contribution agreements. For example, in two instances it stopped payments until it received the required reports. One region has improved its tracking of the reports required from each First Nation. However, not all regions have taken these actions.

15.37 Performance information on community health programs. Apart from a 1998 evaluation of the National Native Alcohol and Drug Abuse Program, a 1999 review of the Tuberculosis program, and a 1999 evaluation of the Indian and Inuit Health Careers Program, there is little information at the national level on the results of individual community-based programs. It is still difficult to attribute results to specific community health programs. Health Canada's recent departmental performance reports to Parliament have provided limited information on the status of community health programs, including outcomes achieved.

Transfer of Health Programs to Community Control

Management of the transfer initiative needs improvement

15.38 In 1997 we found that the Department had developed a sound transfer framework but had not fully implemented it, leaving some gaps and deficiencies. We recommended that it ensure that First Nations meet the requirements for audits, annual reports and evaluations under transfer agreements and that updated community health plans meet the basic requirements and form the basis of both initial and renewed transfer agreements. We also recommended that the Department ensure that future evaluations of the transfer initiative determine the extent to which it has contributed to improving the health of First Nations. As well, the Public Accounts Committee recommended that Health Canada monitor the transfer of the delivery of community health programs to First Nations communities and work with the communities to ensure that they meet the conditions set out in the accountability framework. The Committee also recommended that the Department ensure that the audit and evaluation requirements of all transfer agreements are satisfied. The Department agreed with all of the recommendations.

The Department recognizes that it must give more attention to providing support to help First Nations improve their capacity to meet reporting requirements under contribution agreements.

15.39 In response to our recommendations, the Department updated its transfer handbook, including the requirements for community health plans. It revised the reporting and auditing guidelines to clarify the comprehensive audit requirements specified under transfer agreements. It also revised the requirement for evaluations, which now are to be completed in the fourth year of a five-year agreement to facilitate review and implementation of new strategies as required. This evaluation is intended to serve as the basis for negotiating the renewal of the transfer agreement. The Department is now developing a new accountability framework that it considers will be appropriate as more First Nations take greater control of their health programs through transfer agreements and self-government. The Department stated that a phased implementation of the framework will commence in 2001-02, once it has obtained input from First Nations and completed consultation with them.

15.40 Updated community health plans. In 1997 we observed that about three quarters of renewed transfer agreements we reviewed were based not on updated community health plans but on plans developed at the beginning of the transfer process, more than five years earlier. Our follow-up found that the situation remains the same. We reviewed a sample of 13 agreements that had been renewed for a subsequent term in the period since our 1997 Report. Our analysis identified nine of them (69 percent) that were signed without an updated community health plan.

15.41 Health Canada should work more closely with First Nations to ensure that updated community health plans that meet the basic requirements are prepared, and that they form the basis of both initial and renewed transfer agreements.

Department's response: *Agreed. The Department will establish a more timely and rigorous process to ensure that community health plans are updated as the health priorities of First Nations communities change and, as a minimum, the community health plans will be updated prior to the renewal of transfer agreements.*

15.42 Audits. In 1997 we found that the Department had received an annual audit report on most agreements but that very few of these covered all the aspects required by the Department's comprehensive audit guidelines. The Department subsequently revised the guidelines to clarify the nature and scope of comprehensive audit requirements. Our follow-up found that most First Nations (70 percent) had provided an audit report for 1998-99. However, these reports provided conclusions only on the fairness of the financial statements and not on non-financial commitments, such as compliance with the terms and conditions of the agreement as the guidelines require.

15.43 Health Canada should ensure that the audit requirements under transfer agreements are met.

Department's response: *Agreed. Audit requirements have been clarified. The Department will establish a rigorous monitoring and follow-up process to ensure that the appropriate audit reports are received on a timely basis.*

15.44 Annual reports. In 1997, we reported that while most First Nations prepared annual reports, the Department needed to work with First Nations under transfer agreements to improve the measurement of services provided and of changes to health. Our follow-up found no notable improvement: just under two thirds of the files we reviewed contained an annual report for fiscal year 1998-99. Moreover, the reports were mostly lists of activities undertaken and often did not include performance information.

15.45 Health Canada should continue to work with First Nations to improve the measurement of the services provided and of expected changes to health. These measures should be included in the annual reports and the Department should ensure that these reports are provided.

Department's response: *Agreed. The Department continues to work on the development of measurements and outcomes as part of a new accountability framework. However, it is difficult to establish a direct correlation between services provided and changes expected in health status, because health services are* *just one determinant of health status. Nonetheless, health indicators are being developed and they will be incorporated into appropriate reports as part of the reporting required of communities. The full impact of these improvements will not be known for at least five years, given the length of the evaluation period. The framework is currently being completed in partnership with the Assembly of First Nations (AFN) and the Inuit Tapirisat of Canada (ITC) to help ensure its successful implementation over two fiscal years.*

15.46 **Evaluations.** The Department agreed with our recommendation that future evaluations of the transfer initiative determine the extent to which the initiative has contributed to improving the health of First Nations. It stated that recent improvements in both methodology and technology would assist it in working with First Nations to produce useful and meaningful measurements. The Public Accounts Committee had asked whether a future national evaluation of the transfer initiative was a possibility and whether an evaluation framework had been established. The Department indicated that in its view, more emphasis on community-based evaluations would lead to better health information to determine whether health status had improved. It added that the national perspective on improvement in health status would be derived from an aggregation of community-based evaluations from across the country.

15.47 Only two of four transfer agreements we reviewed in 1997 had been evaluated as required by the transfer agreements. In our follow-up we reviewed the documentation for 14 transfer agreements renewed since 1997. Six were renewed without having the evaluations completed, contrary to the Department's framework.

15.48 The eight evaluations that had been completed varied in quality. They were often hampered by a lack of clear objectives for health programs and, more important, by limited availability of data on which to base an analysis.

15.49 As well, the Department faces challenges in ensuring the timely completion of evaluation plans required of First Nations under transfer. The framework requires that First Nations submit evaluation plans by the end of the first year of the transfer agreement. We found that just over one third of the agreements we reviewed included evaluation plans, and sometimes they had been submitted later than one year into the five-year agreement. It is important that these evaluation plans be completed early on to ensure that adequate data are routinely collected during the course of the agreement.

15.50 Health Canada should ensure that First Nations conduct the required evaluations of the achievement of program objectives and that future evaluations will determine the extent to which the transfer initiative contributes to improving the health of First Nations.

Department's response: *Agreed. The Department will establish a more timely and rigorous approach to ensure that community-based evaluations are completed by communities prior to the renewal of transfer agreements. Improvement in the health of First Nations is difficult to determine, given that First Nations' management of community-based health services, which is the goal of the transfer initiative, is not the only factor that contributes to the health of First Nations. The community-based evaluations will be analyzed and will form the basis of a national perspective on how the transfer initiative contributes to the health of First Nations.*

The Department has underestimated the support needed by First Nations

15.51 Over the past five years, the delivery of community health programs has seen a significant shift from contribution agreements to transfers to community control. Changes in the Branch organizational structure have included staff reductions and zone closures. Although the Branch's budget has increased each year since 1992-93, the number of full-time-equivalent staff has generally decreased. In 1992-93 the Branch had 1,965 full-time-equivalent staff. By 1998-99 this had dropped to 1,263. Health Canada now recognizes that it may have underestimated the ongoing work required to support First Nations as they take on transfer agreements. The Department has been largely focussed on program delivery, and it recognizes that it could have been more diligent in ensuring that reporting requirements were met. It also realizes that it needs to devote more attention to ensuring that First Nations have the capacity and tools to manage and report on their programs and, in some cases, that it needs to sustain this attention over a significant period of time.

Reporting requirements under transfer agreements are still not met.

Non-Insured Health Benefits

Significant concerns remain about the management of non-insured health benefits

15.52 In 1997 we found that Non-Insured Health Benefits program expenditures were not well managed and, in most cases, not properly controlled. Program benefits were subject to abuse by clients and providers. Systems and controls, including verification of claims and audits of providers, were inadequate.

15.53 We also reported in 1997 that prescription drug misuse was not unique to First Nations. However, it had serious implications for First Nations health, particularly when the program was intended to improve it. We noted that there were numerous reports of prescription drug addiction and prescription-drug-related deaths of First Nations individuals in several provinces between 1986 and 1996, and that one region reported 42 prescription-drug-related deaths during 1986-88.

15.54 In addition, we observed in our 1997 chapter that by pharmacy and doctor "shopping", program clients could obtain extremely large amounts of prescription drugs over short periods of time, including mood-altering drugs. The Department was also concerned that some physicians might have been overprescribing mood-altering drugs to First Nations patients. We recommended that Health Canada ensure that the point-of-service system it was implementing for prescription drugs facilitate timely intervention when potentially inappropriate prescription drug use was identified. We also recommended that it provide a clear protocol to guide intervention and closely monitor pharmacists' overrides of warning messages. In cases where it identified a significant pattern of inappropriate use of prescription drugs, we recommended that the Department perform a more rigorous follow-up with clients, physicians, pharmacists and professional bodies. Finally, we recommended that it take appropriate steps to improve controls and edits in the claims-processing system and strengthen the verification of claims. Health Canada agreed with these recommendations.

15.55 Similarly, the Public Accounts Committee recommended that the Department monitor the use of overrides and step up its efforts to devise an incentive scheme for those pharmacists who do not fill prescriptions when warning messages are issued. It also recommended that Health Canada explore with various jurisdictions the possibility of having access-to-information and privacy legislation amended in order to allow its point-of-service system to provide more information on recent prescriptions. Health Canada also agreed with these recommendations.

The point-of-service system for prescription drugs is now fully operational

15.56 At the time of our 1997 audit, the Department was testing a point-of-service system — a key mechanism in the administration of pharmacy benefits and the control of prescription drug use. The system was to be fully implemented in the fall of 1997. However, the use of the point-of-service system was contingent upon pharmacies enrolling in the system, and the take-up was much slower than anticipated. The Department indicated that some pharmacy associations were reluctant at first to endorse the system. By May 1998, only 60 percent of the pharmacies that serve First Nations clients were on-line.

15.57 On 1 April 2000 the system became mandatory, and virtually all pharmacies serving Non-Insured Health Benefits clients are now connected to this system. The Department has reached agreements with three provincial pharmacy bodies on compensating pharmacists for professional services in cases where they have not filled a prescription for valid reasons. However, few pharmacists are taking advantage of this provision.

Inadequate monitoring of drug utilization warning messages

15.58 In 1997 we noted that the point-of-service system then being tested would provide the dates of the client's last three prescriptions. As the system would not provide a client's full drug profile or complete information on doctors visited at the time of dispensing, the Department stated that it intended to strengthen the drug utilization warning messages to pharmacists. We cautioned the Department that it would need to closely monitor pharmacists' overrides of drug utilization warning messages.

15.59 As implemented, the point-of-service system for prescription drugs is not designed to provide detailed information on previous prescriptions obtained or doctors visited. Nor does it provide the dates of the client's last three prescriptions. Drug utilization warning messages remain essentially the same as those proposed. When a pharmacist enters the details of a prescription into a computer, the system may generate any of three drug utilization warning messages (drug-to-drug interaction potential; duplicate drug; duplicate drug-other pharmacy) to which the pharmacist must respond — either to accept the message that the claim is rejected or to override the drug utilization warning message and dispense the prescription. The system may also generate two "soft" messages (duplicate therapy, and duplicate therapy-other pharmacy) that allow for automatic overrides by pharmacists.

15.60 In 1999, nearly seven million pharmacy claims were processed. Data provided by the claims-processing contractor show that the system had generated drug utilization warning messages on 297,693 claims, representing approximately 4.2 percent of all claims. The prescriptions were not filled in 183,914 (61.8 percent) of these cases, representing a total of approximately $5.3 million not claimed.

15.61 Drug utilization warning messages on the remaining 113,779 claims were overridden by pharmacists and the claims were therefore paid by the program — a total of about $3.0 million. The system requires the pharmacist to enter a code that signals the reason for overriding a drug utilization warning message. The reasons provided most often were that the pharmacist had consulted the prescribing physician and filled the prescription as written (42 percent); the client had given an adequate explanation and the prescription was filled as written (25 percent); the pharmacist had cautioned the client and filled the prescription as written (16 percent); and the pharmacist

had consulted another source and filled the prescription as written (11 percent).

We did not find sufficient analysis to indicate whether the drug utilization warning messages are effective.

15.62 However, the Department has not adequately monitored pharmacists' overrides of drug utilization warning messages. In fact, until early 2000 the claims-processing contractor had provided no information to the Branch on the frequency of either the drug utilization warning messages or the overrides. Since March 2000, the Branch has begun to analyze the data. However, we did not find sufficient analysis to indicate whether the drug utilization warning messages are effective; to identify which pharmacists are overriding the warning messages and whether their actions are appropriate, and to determine whether prescriptions rejected by some pharmacists have been filled by other pharmacists. Nor did we find sufficient analysis to indicate how clients with very large numbers of prescriptions are getting through the system and whether there are valid reasons for why this happens.

15.63 Clients are still accessing large amounts of prescription drugs. While the Department has implemented a point-of-service system and some new controls, some program clients are nonetheless still able to access extremely large quantities of prescription drugs. Based on the criteria used by some provincial bodies to monitor prescription drugs, we analyzed departmental data up to the end of the third quarter of 1999-2000. The data show some reduction in some regions in the number of clients going to three or more pharmacies and in the number of clients getting over 15 different drugs over a 90-day period. However, the number of clients getting at least 50 prescriptions filled within a 90-day period has increased in most regions. Overall, the numbers remain high (Exhibit 15.5).

Exhibit 15.5

Analysis of Access to Prescription Drugs by Non-Insured Health Benefits Clients

Region	Number of clients going to 3 or more pharmacies			Number of clients getting over 15 different drugs			Number of clients getting at least 50 prescriptions		
	1st quarter 1996	1st quarter 1999	3rd quarter 1999	1st quarter 1996	1st quarter 1999	3rd quarter 1999	1st quarter 1996	1st quarter 1999	3rd quarter 1999
Pacific	1,931	1,836	1,745	107	126	118	97	137	158
Alberta	5,354	4,693	4,522	867	527	500	387	234	259
Sask.	2,960	3,618	3,130	199	260	233	22	31	124
Manitoba	1,991	2,301	2,225	129	185	170	37	70	62
Ontario	1,728	1,743	1,600	121	145	121	63	97	124
Quebec	373	486	496	39	96	54	84	227	254
Atlantic	678	367	359	137	48	48	20	14	17
Total	**15,015**	**15,044**	**14,077**	**1,599**	**1,387**	**1,244**	**710**	**810**	**998**

Notes:

1. At March 1996 there were approximately 620,000 eligible clients and at March 1999 approximately 672,000.
2. The following criteria (for a 90-day period) are used by some provincial bodies to identify cases for review:

- going to three or more pharmacies to get prescription drugs dispensed
- obtaining more than 15 different prescription drugs
- obtaining 50 or more prescriptions

Source: Health Canada

had consulted another source and filled the prescription as written (11 percent).

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- going to three or more pharmacies to get prescription drugs dispensed
- obtaining more than 15 different prescription drugs
- obtaining 50 or more prescriptions

Source: Health Canada

15.64 Health Canada should more closely monitor pharmacists' overrides of drug utilization warning messages and undertake rigorous analysis on an ongoing basis to assess the effectiveness of the messages.

Department's response: *Agreed. Delays were experienced in the start of the Non-Insured Health Benefits claims-processing contract. Delays in receiving reports from the contractor further held up the implementation of the strategy. The Department uses 19 indicators against which the pharmacists are profiled. As of March 2000, the Department uses this profile when monitoring pharmacists' overrides of drug utilization messages on a three-month retrospective basis. Additionally, the messages themselves will be subject to review and, as part of the strategy, will continue to be changed as required.*

Early success of direct intervention under the drug utilization protocol was not sustained

15.65 In 1997 we found that the Department was slow to intervene in cases of prescription drug misuse. It has since updated and implemented its drug utilization review protocol to better identify and follow up on cases that suggest prescription drug misuse. This intervention — involving following up with clients, physicians, pharmacists and professional bodies — has had some positive impact: in particular, evidence from the Alberta and Saskatchewan regions up to early 1999 shows a decline in the number of cases involving access to large amounts of central nervous system drugs.

15.66 Because management was unsure of the appropriateness of the approach in the absence of either client consent or specific statutory authority for the program, this intervention was stopped in May 1999. The Department issued a revised protocol that states that misuse of benefits will be identified primarily through the point-of-service system (and the drug utilization warning messages that the system generates). Evidence from some regions shows that the number of cases of access to large amounts of central nervous system drugs has started to increase again, and these cases require follow-up.

15.67 In our 1993 Report, we noted that the absence of specific enabling legislation for the Non-Insured Health Benefits program left a gap in the definition of purpose, expected results, and outcomes of program benefits. We recommended that the Department seek a renewed mandate from the government to clarify the program's authority base, purpose and objective. Our 1997 audit found that the renewed policy mandate defined the nature of the program, including its purpose and objective as well as the principles governing it. However, it did not address the need to clarify the authority base for the program. There is still no specific legislation recognizing non-insured health benefits.

15.68 Health Canada is currently considering options to deal with this situation. These include recommending legislation and regulations that would authorize it to use client information in the administration and management of the program, and pursuing positive or voluntary enrolment of clients (one-time signed consent to the use of their personal health information by the program). The option it will choose to pursue will be determined after discussions with First Nations.

15.69 In cases where it identifies a significant pattern of inappropriate use of prescription drugs, Health Canada should continue to perform a rigorous follow-up with Non-Insured Health Benefits clients, physicians, pharmacists and professional bodies. Health Canada should ensure that it has the means to implement this action.

***Department's response:** Agreed. The Department will continue to monitor and profile pharmacists and physicians through its Drug Utilization Review (DUR) initiative. The Department is working with the First Nations on the issue of consent with respect to Drug Utilization Review. Once consent is obtained, Drug Utilization Review will be fully reinstated.*

15.70 As part of our current follow-up we asked for the most recent information the Department had available on prescription-drug-related deaths. It provided us with information from only one region, and, moreover, only to the end of 1997. We believe that the Department needs to collect this information systematically in all regions for use in assessing prescription drug misuse and addiction problems.

15.71 Health Canada should systematically gather data on prescription-drug-related deaths of First Nations individuals in all regions.

***Department's response:** The data are collected by provincial/territorial bureaus of vital statistics and may or may not provide sufficient information related to First Nations and Inuit. The Department agrees to review provincial/territorial information to determine if this information is available and will explore the feasibility of integrating the available information into regional and national comparisons. The Department will continue to liaise with the provinces and territories with respect to prescription-drug-related deaths.*

Work on addressing multiple addiction problems is ongoing

15.72 In 1997 we recommended that the Department build on its existing strategies to address the combined problem of prescription drug abuse and solvent and alcohol abuse, and increase efforts in community health programs for prevention, community education and treatment of prescription drug addiction.

15.73 The Department recognized that multiple addiction is a long-term and complex problem. It has developed a national educational program on prescription drug use and misuse. Work is ongoing with National Native Alcohol and Drug Abuse Program treatment centres to define the complexities of the problem. Training in dealing with multiple addictions has been initiated for treatment centre staff. Continuing effort to integrate community health programs is needed to deal with multiple addictions.

15.74 Health Canada should continue to build on its existing strategies to address the combined problem of prescription drug abuse and solvent and alcohol abuse, and increase efforts in community health programs relating to prevention, community education, and treatment of prescription drug addiction.

***Department's response:** Agreed. Work continues with First Nations and Inuit communities on the correct use of prescription drugs and the problems of prescription drug misuse. Two educational videos were produced and distributed to all First Nations and Inuit communities. As a result of the positive responses to the videos, additional prevention and promotion activities are under way. These include the development of tools to facilitate community-level discussions of prescription drug misuse, televised public service announcements that will be aired in late fall 2000 or early in 2001, and community drug profiles that will allow community health professionals to identify and address potential issues surrounding prescription drug use and misuse. In addition, the Department has targeted National Native Alcohol and Drug Abuse Program (NNADAP) Centres to deal specifically with issues of multiple or cross addiction, and it agrees to continue building on existing strategies and programs to ensure a consistent approach* *to the combined problem of prescription drug, solvent and alcohol abuse. The Department will ensure that prevention and promotion materials and community education address the combined problem.*

Health Canada has been slow in developing an appropriate strategy for audit of providers

15.75 In 1997 we identified significant risks associated with the Non-Insured Health Benefits program. We found weaknesses in claims-processing controls and edits and stressed the need to strengthen verification of claims and audits of providers. In particular, we found that on-site audits of providers did not provide a reasonable degree of assurance that expenditures had been made for the intended purposes. The audit strategy was not based on an appropriate assessment of risks, and audits were targeted mainly at a small number of high-volume providers. In addition, we recommended that the Department clarify and enforce compliance with the contract requirement for audit of pharmacy and dental providers by the contractor. The Department agreed, stating that improvements had been made to the audit provisions of the new claims-processing contract.

15.76 The new claims processor's contract was signed on 16 October 1997, with claims-processing services commencing 1 December 1998. The signing of a new contract gave the Department an opportunity to specify requirements that would fill some of the deficiencies identified in our 1997 audit. However, our follow-up found that a number of those deficiencies have not yet been corrected.

15.77 The contractor proposed an overall audit approach that included applying criteria to profile pharmacies and dental providers for audit and conducting 60 on-site audits of both pharmacies and dental providers annually; and undertaking reviews of claims submissions — referred to as next-day on-line audits — that would meet specified criteria. In addition, the Department also considered dental predetermination (described in paragraphs 15.90 and 15.91) to be an important component in reducing risks related to dental benefits.

15.78 The Department advised the Public Accounts Committee, in a letter dated 12 February 1998, that audit provisions had been strengthened in the new claims-processing contract. On 30 April 1998, the Chair of the Committee asked for details about the new contract, including the number of provider audits that would be undertaken; how the audits would be conducted; what steps would be taken to ensure that providers comply with audit requirements; how conditions set forth in the new contract would provide assurance that expenditures are made for the intended purposes; and whether the audit strategy under the new contract would be based on an appropriate assessment of risks.

15.79 The Department responded in May 1998 that it had contracted with a national consulting firm to help develop a plan for improving audit capacity. This would include providing advice on a new audit strategy based on assessment of risks, audit coverage and how audits would be conducted. The firm completed its examination in November 1998. The examination identified significant gaps between what the new claims-processing contractor was contracted to deliver and what is required to adequately address issues facing the Non-Insured Health Benefits program.

15.80 The consulting firm concluded that because of limitations in the contract and the contractor's mandate, the overall level of audit activity mutually agreed upon by the contractor and the Department would not be sufficient to accomplish the Department's goals and objectives and to adequately address the issues raised by the Auditor General. The firm stated that there is a significant gap between the depth of the audit coverage and the overall risk of the program, and that the contract does not promote increased levels of audit activity to minimize that risk.

15.81 In response to the consulting firm's recommendations, the Branch decided in October 1999 to establish a risk management team in the fourth quarter of 1999-2000. In the first quarter of 2000-01 the team would identify the risks to the program, and in the second quarter it would develop and implement risk controls.

Few of the required on-site audits of providers have been completed

There is a significant gap between the depth of the audit coverage and the overall risk of the program.

15.82 Approximately 7,000 pharmacies and 22,000 dental providers serve First Nations clients. The contractor is required to perform no fewer than 60 on-site audits of pharmacies and 60 on-site audits of dental providers annually. Even though the consulting firm concluded that the audit coverage was inadequate, we found in our follow-up that the Department had not ensured that the contractor complied with this existing requirement. Only 29 on-site pharmacy audits were undertaken in 1998-99, and another 24 were initiated in 1999-2000. Only one on-site audit of a dental provider has been performed in the last two fiscal years. Health Canada has indicated that it expects the contractor to make up for the shortfall in on-site audits by the end of fiscal year 2000-01.

15.83 In addition to routine audits of providers, some investigations into suspected fraudulent practices have been undertaken with the involvement of the Department's internal audit directorate. These investigations recently resulted in two convictions. Several other investigations are under way.

15.84 The contractor has carried out next-day on-line audits since December 1998. These are done the day after a claim is submitted, and they focus on a sample of claims above a specific dollar threshold to determine if further investigation is warranted. We note that this threshold is several times higher than the average value of a pharmacy claim. Of the nearly seven million pharmacy claims submitted in 1999, about 150,000 or 2.2 percent were above the threshold. Of these, the contractor reviewed a sample of around 12,000 or 8.0 percent — only 0.2 percent of all claims submitted in 1999. The Department reported that a total of approximately $159,000 was recovered as a result of this procedure. This is an important component of the audit strategy but given the limited coverage, it is important that the other components of the audit strategy be fully implemented.

Other problems with claims-processing contract

15.85 **Non-compliance with reporting requirements.** As part of its contractual obligation, the contractor is to generate a series of monthly and quarterly reports on activities related to pharmacy benefits (for example, lists of all claims that were adjusted/reversed and recoveries made as a result of system edits) so the Department can monitor the contractor's performance. However, the contractor did not provide any of these reports in 1999 although the Department asked for them. The first reports were not provided until January 2000. To date, the Branch has withheld from the contractor a total of approximately $1.6 million in monthly payments for not fulfilling its contractual obligations.

15.86 In 1997 we identified problems with the system edits used to identify duplicate claims. In our follow-up, we were encouraged to find that those problems have been resolved. A departmental report indicates that in 1999, system edits prevented almost 100,000 duplicate claims totalling $3.1 million from being processed.

15.87 We noted in our 1997 Report that the contractor had not performed any procedures to confirm that Non-Insured Health Benefits clients had received the benefits for which claims had been submitted. Our follow-up found that the contractor incorporated a procedure in its audit program for on-site audits of pharmacies to confirm that clients have received benefits. However, it did not follow up on cases where no confirmation was received from the client. We believe there is a need to follow up on such cases and to pursue client confirmations on a broader basis.

15.88 We also found in 1997 that the system field identifying the doctor who wrote the prescription was not subject to any system edits but rather accepted anything that was input. Therefore, it was not possible for the Department to accurately track "doctor shopping" — individuals visiting multiple doctors to obtain a large number of prescription drugs. The Department has not yet corrected this problem. It is currently working with pharmacy associations to encourage pharmacists to fill out the prescriber identification field correctly. In addition, it has begun tracking pharmacists who do not fill in this field properly and it has indicated that it will take steps to recover funds for claims that do not have correct prescriber identification, beginning in July 2000.

15.89 Health Canada should enforce the contract requirements for audit of pharmacy and dental care providers and reporting by the contractor. The Department should continue to take steps to strengthen verification of claims and audits of providers.

***Department's response:** Agreed. The development and full implementation of the audit strategy has taken longer than initially expected. The Department continues to enforce the contract requirements. The Department withheld approximately $1.6 million in monthly payments to the contractor for not fulfilling its contractual obligations. The contractor will make up in fiscal year 2000-01 the audits that were to have been completed since 1998. The dental predetermination process ensures that virtually all dental claims exceeding $600 are reviewed against the dental history of each client. A Risk Management Committee ensures that the audit strategy is reviewed on a regular basis. As noted earlier, the development of the full audit strategy took longer than expected but will be fully implemented by the fall 2000. At that time, the fully implemented comprehensive strategy will greatly exceed existing standards of private benefits management. The Department is committed to the continuous improvement of the audit strategy.*

Needs-based approach for dental benefits has resulted in substantial savings

15.90 In 1997 we reported that in response to concerns about overservicing by dental care providers, the Department was piloting a predetermination process. It required prior approval and a treatment plan for performing dental services above a prescribed dollar threshold. Predetermination was implemented nationally in late 1997 as a needs-based approach to providing dental care. The Department estimated that predetermination, combined with changes to the benefit schedule, would result in a 15 percent reduction of dental costs in 1996–97.

The predetermination process for dental benefits has reduced both overservicing and program costs.

15.91 With predetermination, the Department has taken steps to respond to overservicing. Any treatment that exceeds the threshold of $600 and/or that includes selected procedures must be reviewed by a regional dental officer before treatment begins. In 1999 the Department reviewed almost 200,000 treatment plans. It is confident that predetermination has reduced both overservicing and program costs. It has also resulted in substantial savings: a 15.4 percent reduction in dental costs was realized in 1996-97. In 1995-96, before the approach was introduced, dental expenditures were over $123 million. In 1998-99 they had dropped to just over $106 million, whereas the population being served has increased by almost 8 percent.

Limited progress made to improve efficiencies in medical transportation

15.92 In 1997, we recommended that the Department establish clear program criteria and minimum standards for medical transportation benefits. We also said that it should undertake audits of medical transportation expenditures based on an assessment of risks.

15.93 Working with First Nations, the Department has begun to clarify program criteria and minimum standards for medical transportation benefits. It is also attempting to address criticisms that First Nations are not treated consistently from one region to another. However, it has not yet updated the national transportation directives.

15.94 Approximately 54 percent of medical transportation expenditures are administered by First Nations communities under contribution agreements, which are subject to planned departmental audits. The other 46 percent of expenditures are administered by Branch regional offices, with payments made directly to providers by the Department. While we noted more daily monitoring and prior approval of certain categories of transportation in some regions, the Department has not conducted any audits of transportation expenditures paid directly to providers.

15.95 An internal review of the medical transportation program in one region was completed in March 1999. It concluded that the medical travel program in that region was not being managed well overall. It found major problems in several areas: weaknesses in managing the use of taxis or contracted vehicles; use of ground ambulances for more than emergencies; poor controls over gas support; and little or no information on the use and costs of the medical travel program. In addition, it found that program spending was not based on need; rather, in many cases, it was based on use, so the more a community spent on medical travel, the more money it received.

15.96 The region subsequently developed a needs-based transportation model to profile the realistic transportation needs of individual First Nations. The Department has set a target date of spring 2001 for national implementation of the needs-based transportation model.

15.97 Health Canada should establish clear program criteria and minimum standards for medical transportation benefits without delay. It should also undertake audits of medical transportation expenditures based on an assessment of risks.

Department's response: *Agreed. To facilitate better control over medical transportation benefits, a review of the transportation directive is under way with First Nations and Inuit, as is the development of an information system to support profiling and audit. Fifty-four percent of medical transportation costs are managed primarily through contribution agreements with First Nations, which are subject to audit as part of the Department's planned auditing requirements. The Department will audit the direct medical transportation expenditures, based on an assessment of risks, cost effectiveness and monitoring profiles.*

Most Non-Insured Health Benefits transfer pilot projects have not been evaluated

15.98 In 1994, Health Canada received a five-year authority to proceed with

Non-Insured Health Benefits pilot projects with interested First Nations and Inuit communities. The primary objectives were to test various management and delivery options, to improve the program's efficiency and effectiveness, and to facilitate First Nations and Inuit involvement in, and control of, the program. The pilot projects were to operate for two years with an optional third year. An interim evaluation of each pilot was required after the first year, and a final evaluation when each project ended. At the end of the pilot exercise, an overall evaluation of its effectiveness would be conducted, including an assessment of the objectives, impacts and effects.

15.99 Health Canada approved 16 pilot projects, mainly involving transportation benefits but also covering pharmacy, dental, and vision benefits. So far, only five of the projects have been evaluated and there has been no overall evaluation of the effectiveness of the pilot exercise. The original authority for these pilots has expired, and the Department has requested Treasury Board approval to extend it.

15.100 Health Canada should ensure that it completes an evaluation of each of the Non-Insured Health Benefits transfer pilot projects, as well as an overall evaluation of the pilot exercise.

Department's response: *Agreed. The Department completed evaluations of five of the pilot projects to pretest the evaluation tool. The pretest indicated that additional development of the tool was required. This development is ongoing and the Department has met with all communities undertaking the pilot projects to discuss the evaluation tool and upcoming evaluations. Once all projects have been evaluated, an overall evaluation of the pilot exercise will be conducted.*

New Initiatives

Attention has to be given to monitoring new initiatives

15.101 In response to our concerns in 1997 about unclear objectives, Health Canada indicated that new programs would have clear requirements for accountability and performance reporting. The Department has begun a number of new initiatives and programs since our 1997 audit (Exhibit 15.6). These are important initiatives with the potential to fill significant gaps in First Nations health programming.

15.102 Because these initiatives are in their early stages, we reviewed their design and early implementation. We found that the Department is taking steps to ensure that their objectives and accountability structures are clear and there is an emphasis on measuring results. For example, the Aboriginal Head Start (On-Reserve) Program has a national evaluation framework, and there is an accountability framework for the Home and Community Care Program. However, our review of files found that not all reports required under the various contribution agreements were in the files. As with other community health programs, it is important that full attention be given to monitoring contribution agreements under these new initiatives to ensure that requirements are met.

15.103 First Nations Health Information System. The system's focus is on creating an epidemiological database to support program delivery, priority setting, planning and evaluation in each community. There are 13 subsystems available and they cover a wide range of areas, from immunization to chronic diseases. Health Canada is acting to provide the systems and necessary training to any First Nation who indicates an interest in voluntarily participating in this system.

15.104 Implementation of the system across the country has just begun — most participating First Nations are so far inputting data for only the immunization subsystem. It will be a complex task to harmonize the diverse needs of First Nations and create a system that allows for the collection of comparable data to facilitate the objective of eventually developing a comprehensive First Nations health surveillance program. Critical tasks for Health Canada will be to bring all parties together to ensure that this is accomplished, and to identify mandatory data to be collected where applicable. The Department is now working with First Nations and provinces to develop uniform standards and protocols for collecting and reporting data in order to ensure comparability with other jurisdictions. The Department also recognizes that linkages to other systems are essential.

Exhibit 15.6

Health Canada Initiatives Since 1997 Audit

Initiative	Overall Objective and Funding	Progress to date as of 31 March 2000	Delivery Mechanism	Accountability Framework & Evaluation Component
First Nations Health Information System • additional funding announced in 1999 Budget	• To improve the management of health services within First Nations communities as an initial version of a comprehensive community health information system • $23 million over four years and then $20 million annually	• early implementation • system installed in 265 First Nations	• Health Canada provides infrastructure and training • contribution agreements with First Nations for data entry	• evaluation framework established
Aboriginal Head Start (On-Reserve) Program • announced by Minister of Health in October 1998	• To support early child development strategies designed and controlled by First Nations • $100 million over four years and then $25 million annually	• early implementation • 156 projects funded and additional 47 First Nations completed needs assessments	• contribution agreements with First Nations	• national evaluation framework developed
Home and Community Care Program • announced in 1999 Budget	• To provide improved care for the elderly, disabled, chronically ill and those requiring short-term acute care services • $62 million over two years and then $90 million annually	• early implementation • over 400 First Nations communities participating	• contribution agreements with First Nations	• accountability framework completed but evaluation framework still outstanding
Aboriginal Diabetes Initiative • announced in 1999 Budget and launched by Minister of Health in November 1999	• To decrease diabetes and its complications in First Nations and Inuit communities • $58 million over five years	• planning phase	• contribution agreements with First Nations	• to be developed

15.105 Aboriginal Diabetes Initiative. In 1997 the Department completed a study that included constructing a preliminary estimate of the cost of health care for First Nations persons with diabetes. The study noted the greater prevalence of diabetes and the higher mortality rate among First Nations peoples than among the general population. It pointed to the importance of policies for reducing the prevalence of diabetes through primary prevention, and treating those diagnosed to reduce the impact of complications. In November 1999, the Department announced its Aboriginal Diabetes Initiative, aimed at decreasing the incidence of diabetes and its complications in First Nations and Inuit communities. At the time of our audit, an evaluation framework had not yet been developed. This initiative addresses a very serious disease, and it is important that it be implemented effectively to ensure that work undertaken contributes to meeting its objectives.

Conclusion

15.106 The action Health Canada has taken in response to our 1997 audit of First Nations Health has not adequately addressed our observations and recommendations or those of the Public Accounts Committee. Continued and sustained effort is needed to ensure that all the recommendations are fully implemented.

Continued and sustained effort is needed to ensure that all the recommendations are fully implemented.

15.107 The management of separate contribution agreements for the delivery of community health programs is still weak. There has been limited improvement in reducing program overlap, ensuring that programs have clear objectives, and ensuring that the required reports are provided. The Department needs to fulfil its responsibilities in a way that helps First Nations establish programs and services likely to improve their health.

15.108 Management of transfer agreements still needs improvement. Sound monitoring is needed to ensure that updated community health plans are prepared and that the requirements for audits, annual reports and evaluations are met. These are required not only to meet the accountability obligations of First Nations and the Department but also to improve the programs and services.

15.109 We still have significant concerns about the management of non-insured health benefits. While a point-of-service system for prescription drugs is now operating, the Department needs to adequately monitor pharmacists' overrides of drug utilization warning messages. It also needs to undertake sufficient analysis of the effectiveness of the warning messages. The Department needs to find appropriate means to continue to follow up rigorously on cases where it identifies a significant pattern of inappropriate use of prescription drugs. In addition, it needs to ensure that required on-site audits of pharmacies and dental providers are undertaken. Finally, it needs to improve efficiencies in administering medical transportation benefits.

15.110 Improving the health of First Nations is a complex task. The programs that Health Canada delivers either directly or in partnership with First Nations organizations represent a key component of this task. We believe that timely and complete implementation of our recommendations would contribute to improving the health services to First Nations.

***Department's overall response:** In responding to the recommendations, the Department feels it is important to set out some context around the responses. In particular, the Department remains committed to implementing the actions set out in our responses to both the 1997 and 2000 reports. While action has been taken on all the recommendations from the 1997 report, and this has been acknowledged in the 2000 report, there are a number of* *reasons for the time it has taken to fully implement the action plan.*

First, the development of the overarching accountability framework, which was initiated in response to the 1997 report, has proved to be more complex than was initially foreseen. The framework will enable the Department to demonstrate value for the investment made in programs, identify gaps, manage risks to health, improve capacity to deliver services, and improve overall management practices. This is being carried out through 10 working groups in partnership with First Nations and Inuit. The recommendations are being addressed through this process.

Second, implementing the Non-Insured Health Benefits claims-processing contract has also proved to be more complex than anticipated, as the Department sought to ensure that the recommendations relating to Non-Insured Health Benefits management were fully addressed. Systems edits and drug utilization messages required considerable attention, as the Department attempted to ensure that the claims-processing system would better any system in the private sector. The Department believes it will soon achieve the goal, and by fall 2000 the system will be fully implemented. It should be noted that the Department's management of Non-Insured Health Benefits expenditures in 1999-2000 outperformed that of the private and public sector benefits plans in both pharmacy and dental benefits.

Finally, the Department has worked on the recommendations in partnership with First Nations and Inuit. Ultimately, this partnership approach will help ensure that the recommendations are responded to in a way that supports First Nations and Inuit goals of responsive, community-based programming, appropriate reporting requirements that also meet their needs, and a strong Non-Insured Health Benefits management process that can support the transfer of Non-Insured Health Benefits to First Nations.

About the Follow-up

Objective

The objective of this audit was to determine the progress made by Health Canada in taking corrective action on the observations and recommendations in our 1997 chapter on First Nations Health and on recommendations made by the Public Accounts Committee in 1998.

Scope

The follow-up covered the recommendations made in our 1997 Report, Chapter 13, First Nations Health, as well as recommendations made by the Public Accounts Committee. These recommendations relate to Health Canada's health programs directed at First Nations, including community health programs delivered through separate contribution agreements, transfer of health programs to community control, and Non-Insured Health Benefits. We also undertook a follow-up of outstanding recommendations reported in Chapter 19 of our 1993 Report on the Non-Insured Health Benefits program.

We reviewed a departmental status report on the action taken in response to the recommendations. With respect to community health programs delivered to First Nations using separate contribution agreements and transfer agreements, we performed a detailed analysis of a sample of 35 agreements in each category. We also looked at the design and early implementation of several related new initiatives and the First Nations Health Information System. In addition, we reviewed current systems, controls and management practices relating to the delivery of non-insured health benefits.

We carried out extensive interviews with program managers at First Nations and Inuit Health Branch headquarters and selected regional offices, and with the contractor for claims processing of dental and prescription drug benefits. We also met with selected representatives of First Nations communities and organizations. In addition, we reviewed program documentation and related literature.

Criteria

We expected that the Department would have implemented the recommendations it committed to do in its responses to our 1997 chapter and to the Public Accounts Committee.

Audit Team

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Appendix

First Nations Health – Follow-up: Overall Assessment of Progress Made

Reference[1]	Recommendation	OAG Assessment
Community Health Programs Delivered Through Separate Contribution Agreements and Transfer of Health Programs to Community Control		
13.36	Health Canada should review its program structure and ensure that it reflects the manner in which the programs are actually delivered.	Satisfactory progress. The Department has initiated a project that will identify specific objectives for each program, and it believes this will alleviate overlap of program objectives. At the time of our audit this had not been completed; we found that there is still some overlap between program objectives.
13.40	The Department should ensure that the contribution agreements are clear about specific objectives and activities that the First Nations will undertake. It should encourage First Nations to define measures of success.	Unsatisfactory progress. In many cases, programs still do not include clear objectives and activities for the specific community.
13.44	The Department should ensure that it receives the activity reports required under contribution agreements. It should work with First Nations to improve these activity reports so that they provide information on results achieved.	Satisfactory progress. Some improvement, but not all required activity reports are completed for all programs. Reports remain mostly lists of activities undertaken.
PAC No. 2	That Health Canada monitor those aspects of the community health programs that are not affected by transfer agreements. This monitoring function must be done in accordance with departmental policies, be supported by thorough evaluation of risks, and targeted accordingly.	Unsatisfactory progress. Monitoring of reporting requirements remains weak. The proposed automated contribution system to track reports is not yet operational in all regions.
13.58	The Department should ensure that updated community health plans that meet the basic requirements are prepared, and that they form the basis of both initial and renewed transfer agreements.	Unsatisfactory progress. Many renewed agreements were signed without an updated community health plan.
13.65	The Department should work with First Nations to improve measurement of the services provided and of expected changes to health. These measures should be included in the annual reports. In addition, the Department should ensure that First Nations conduct the required evaluations of the achievement of program objectives.	Unsatisfactory progress. Under two thirds of transfer agreement files reviewed had an annual report for 1998-99. Those provided tended not to include performance information. Some transfer agreements were renewed without evaluations having been completed. Some completed evaluations had quality problems.
13.70	The Department should clarify the nature and scope of audit requirements under transfer agreements and ensure that the required audit opinions are provided.	Satisfactory progress. The Department has revised its audit guidelines to clarify the nature and scope of comprehensive audit requirements. Not all transfer agreements had audits completed as required. Audit reports provided did not meet all requirements.

[1] These refer to recommendations made in our audit on First Nations Health (1997 Report, Chapter 13) and to recommendations made in the Public Accounts Committee's Fifth Report, tabled in February 1998.

Reference	Recommendation	OAG Assessment
Community Health Programs Delivered through Separate Contribution Agreements and Transfer of Health Programs to Community Control (continued)		
13.74	The Department should ensure that future evaluations will determine the extent to which the transfer initiative contributes to improving the health of First Nations.	Unsatisfactory progress. The Department believed that more emphasis on community-based evaluations would lead to better health information to deal with the issue of improved health status. As noted above, community-based evaluations were either not done or inadequate.
PAC No. 1	That Health Canada monitor the transfer of the delivery of community health programs to First Nations and work with the communities to ensure that the conditions set forth in the accountability framework are met. In particular, the Department must ensure that the audit (both financial and comprehensive) and evaluation requirements of all transfer agreements are satisfied.	Unsatisfactory progress. The accountability framework is still under development. As described above, audit and evaluation requirements have not been met satisfactorily.
PAC No. 3	That Health Canada provide information on the status of community health programs in its annual Performance Reports. Information on the status of the transfer process, the Department's monitoring activities, audits and reports completed, and health outcomes achieved under the programs should be included.	Unsatisfactory progress. Recent departmental annual performance reports have provided limited information on the status of community health programs, including outcomes achieved.
Non-Insured Health Benefits		
13.114	In cases where it identifies a significant pattern of inappropriate use of prescription drugs, the Department should perform a more rigorous follow-up with Non-Insured Health Benefits clients, physicians, pharmacists and professional bodies.	Satisfactory progress. A protocol was implemented to follow up on cases of suspected drug misuse, with some success. However, officials stopped following the protocol in May 1999 as management was unsure of the appropriateness of the approach in the absence of either client consent or statutory authority. The Department is currently considering options to deal with this situation.
13.120	In implementing the point-of-service system for prescription drugs, the Department should ensure the system will facilitate timely intervention where potentially inappropriate prescription drug use is identified. The Department should provide a clear protocol to guide intervention and should closely monitor pharmacists' overrides of warning messages.	Unsatisfactory progress. The point-of-service system provides limited information in the form of warning messages to assist pharmacists in making decisions on dispensing prescriptions. This resulted in rejection of a number of claims. But Health Canada has not adequately monitored the warning messages that were overriden by pharmacists. Nor has it undertaken sufficient analysis of the effectiveness of warning messages. The Department has agreed with three provincial pharmacy bodies on compensating pharmacists for professional services in cases where they have not filled a prescription for valid reasons, but few pharmacists have taken advantage of the provision.
PAC No. 4	That Health Canada explore the possibility, with various jurisdictions, of having access to information and privacy legislation amended in order to allow its point-of-sale system to provide more information on recent prescriptions.	
PAC No. 5	That Health Canada monitor the use of overrides by pharmacists and step up its efforts to devise an incentive scheme for those pharmacists who do not fill prescriptions when warning messages are issued.	

Reference	Recommendation	OAG Assessment
Non-Insured Health Benefits (continued)		
13.123	The Department should build on its existing strategies to address the combined problem of prescription drug and solvent and alcohol abuse, and increase efforts in community health programs relating to prevention, community education, and treatment of prescription drug addiction.	Satisfactory progress. Multiple addiction is a systemic, long-term and complex problem. Departmental efforts are ongoing.
13.140	Health Canada should clarify, and enforce, the contract requirement for audit of pharmacy and dental care providers by the contractor. The Department should take appropriate steps to improve claims-processing system controls and edits and strengthen verification of claims and audits of providers.	Unsatisfactory progress. The Department was slow to develop and incorporate an audit strategy based on appropriate assessment of risks in its new claims-processing contract. It failed to ensure that the contractor would perform the required on-site audits of pharmacy and dental providers. Problem with system edit to identify duplicate claims has been resolved.
13.149	Health Canada should establish clear program criteria and minimum standards for medical transportation benefits. It should also undertake audits of medical transportation expenditures based on an assessment of risks.	Unsatisfactory progress. Work on updating national transportation directives has not yet been completed. No evidence of any audits of transportation expenditures paid directly to providers.
PAC No. 6	That Health Canada fix systemic problems with the Non-Insured Health Benefits program before the program becomes available for transfer to First Nations communities.	Unsatisfactory progress. As described above, many problems have not yet been fixed.
PAC No. 7	That Health Canada adopt and apply the framework for transferring community health programs when it conducts the transfer of the Non-Insured Health Benefits program to the First Nations.	Unsatisfactory progress. Most Non-Insured Health Benefits transfer pilots have not been evaluated. A new accountability framework is still under development.
PAC No. 8	That Health Canada submit a copy of the new contract for processing pharmacy and dental claims under the Non-Insured Health Benefits program to the Committee by 1 June 1998.	Fully addressed. A copy of new contract was provided to the Committee.
PAC No. 9	That Health Canada work with First Nations communities to establish optimal therapy as the central goal of the Non-Insured Health Benefits program and include references to this effort in its annual Performance Report.	Unsatisfactory progress. Predetermination process for dental benefits implemented. As described above, officials stopped following the drug utilization review follow-up protocol, which forms a part of a strategy to improve drug therapy. Limited information contained in the Department's recent annual performance report referencing this effort.

Reference	**Recommendation**	**OAG Assessment**
Non-Insured Health Benefits (continued)		
PAC No. 10	That Health Canada provide the Committee with a copy of its action plan for carrying out the recommendations made by the Auditor General by 30 April 1998. This plan should include target implementation dates, and a discussion of how the Department proposes to monitor and report the changes and the results that are achieved.	Fully addressed. An action plan was forwarded to the Committee in February 1998. The Department advised the Committee that it intended to update this plan on a semi-annual basis until full implementation is achieved.

Key:

Fully addressed - the Department has fully addressed the original audit finding and thus need not take additional action. Our Office will not follow up further.

Satisfactory progress - the Department has made reasonable progress in addressing the original finding, but must take some additional action. Our Office will do further follow-up work.

Unsatisfactory progress - the Department has not made reasonable progress in addressing the original finding, and must take considerable additional action. Our Office will do further follow-up.

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October 2000

This October 2000 Report comprises 8 chapters as well as a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 16

Follow-up of Recommendations in Previous Reports

The follow-up work was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Follow-up of Recommendations in Previous Reports

Main Points

16.1 This chapter presents our follow-up of six audits originally published between 1995 and 1998. In the final volume of this year's Report, due to be tabled in December 2000, we will publish an additional follow-up chapter and provide a general conclusion of the government's progress in addressing the concerns we raised in previous reports.

16.2 The policy and legislative environment of the financial services sector has changed considerably since our 1995 and 1997 Reports. Canada's regulatory system for this sector is sound and the Office of the Superintendent of Financial Institutions (OSFI) has taken many satisfactory steps to deal with our previous recommendations. However, with all the expected changes that will affect the financial services sector, OSFI's ability to supervise and regulate could be challenged in the short term. Furthermore, in this changing environment, recruiting and retaining employees will become a bigger challenge.

16.3 Although progress has been slow on addressing the recommendations of our November 1995 chapter — Revolving Funds in the Parliamentary System: Financial Management, Accountability and Audit — recent initiatives by the Treasury Board Secretariat substantially address our recommendations.

16.4 The Canada Industrial Relations Board, formerly known as the Canada Labour Relations Board, has made progress in addressing our concerns about financial control problems. Payment to former members was the single biggest expenditure of the Canada Industrial Relations Board's $1.7 million in transition costs. We also observed that the government, as a whole, has not taken adequate action to improve the accountability framework governing travel and hospitality expenditures of senior Governor in Council appointees.

16.5 National Defence has made significant progress in addressing its lack of plans and priorities for its capital acquisition program. The management of individual major capital projects has also improved. The Department has gone beyond its original commitments to make improvements. Nevertheless, officials estimate that the Department is still about $750 million a year short of the amount needed to modernize and maintain readiness. The "hard choices" referred to in 1998 have been identified, but not all of them have been made.

Introduction

16.6 It is our policy to make recommendations in all of our audits that are oriented toward correcting current or future problems and improving the management of government. We encourage management of the entities that we audit to respond to us in writing, stating whether they agree with our recommendations, and how they plan to implement corrective action. We, in turn, publish their responses in our report, so that Parliament and the public will be able to judge their commitment.

16.7 It is important for readers to understand what a follow-up is, and is not. Apart from a few unique situations, it is not a second audit of the same issues. Rather, it is a report on what management tells us, or can demonstrate to us, about the progress it has made toward meeting our recommendations since our initial report on the subject. We do not exhaustively seek or examine additional evidence to support or refute what management has told us, but we do review its claims for reasonableness and report to Parliament accordingly.

16.8 This chapter represents a change from our practice of reporting follow-up only once a year. We have included five follow-up segments in this volume that were completed in time for this Report. In the final volume of this year's Report, due to be tabled in December 2000, we will publish an additional follow-up chapter and provide a general conclusion of the government's progress in addressing the concerns we raised in previous reports.

Office of the Superintendent of Financial Institutions — 1995, Chapter 5 and 1997, Chapter 30

Assistant Auditor General: Ron Thompson
Director: Richard Domingue

Background

16.9 The Office of the Superintendent of Financial Institutions (OSFI) has regulatory and supervisory responsibilities for almost 500 federally regulated financial institutions (including banks, trust and loan companies, co-operative credit associations, fraternal benefit societies and all federally registered insurance companies) and over 1,150 pension plans.

The financial services sector, the legislative framework and the policy environment in which the financial services industry evolves have changed considerably since 1995.

16.10 In our 1995 Report, we discussed our audit of the sector of OSFI that oversees deposit-taking institutions. We made a series of recommendations dealing with the assessment of policy objectives, the accountability framework, the risk management of deposit-taking institutions, the systems and capabilities to deal with changes in the financial services sector, and the relationship among the principal players in the federal regulatory framework.

16.11 Later that year, the Public Accounts Committee heard witnesses and issued a report that focussed on several key areas for improvement. These included the need to conduct a program evaluation of the supervisory and regulatory framework, to better define the role, responsibilities and mandate of each responsible entity, to review the overlap between OSFI and the Canada Deposit Insurance Corporation (CDIC) and to design an action plan for intervention.

16.12 In our 1997 Report, we reported on the insurance and pensions operations of OSFI. We made recommendations on human resources management, the risk assessment framework and guidelines, and relationships and communications with other regulators. The Public Accounts Committee also heard witnesses and reported that OSFI needed to review its human resources system, identify factors explaining its poor staff retention and implement measures to alleviate this problem. The Committee recommended that OSFI reorganize its risk monitoring and actuarial functions and consolidate them in the supervisory functions.

16.13 The financial services sector, the legislative framework and the policy environment in which the financial services industry evolves have changed considerably since the publication of our two chapters on OSFI. The government has undertaken numerous policy initiatives and legislative reviews. For example, the Department of Finance has published two policy papers since 1995. In addition, extensive reviews were conducted of the *OSFI Act*, the *Canada Deposit Insurance Corporation Act* (*CDIC Act*) and the *Pension Benefits Standards Act*. The financial services legislative framework was updated in 1997 and is currently being reviewed.

16.14 Bill C-38 was introduced in Parliament in June 2000. It followed a June 1999 policy paper published in response to a report in September 1998 by the Task Force on the Future of the Canadian Financial Services Sector (the MacKay report). Among other issues, the MacKay Task Force reviewed the regulatory framework. It concluded, "[Canada has] a strong prudential regulatory framework that, in many respects, is a model that many other countries are now emulating." However, the report proposed measures such as streamlining regulatory practices, improving the federal prudential regulatory framework, reviewing OSFI's statutory obligations to include consumer protection responsibilities and assuming the responsibility of balancing competition and innovation. It also made specific recommendations addressing the overlap between CDIC, OSFI and provincial regulators.

Scope

16.15 Our follow-up work included a review of status reports prepared by OSFI on the progress made in response to our two chapters. We reviewed supporting documents provided by OSFI, the Report of the Task Force on the Future of the Canadian Financial Services Sector and the Department of Finance policy papers, including the most recent set of legislative proposals. We also conducted interviews with OSFI officials. Finally, we reviewed a recent International Monetary Fund (IMF) assessment of the stability of Canada's financial system.

Conclusion

Canada has a sound regulatory framework

16.16 Earlier this year, an International Monetary Fund review concluded, "the financial system in Canada is among the soundest in the world and the regulatory framework conforms in nearly all respects with international standards." The review noted full compliance with 23 of the Basel Core Principles of Effective Banking Supervision and partial compliance with the remaining two principles (authority to change a bank's board and management, and authority to bar an individual from banking once hired). The 1999 Department of Finance policy proposals and the adoption of Bill C-38 will ensure full compliance with all principles. The review also concluded, "Canadian regulators have been at the forefront internationally in developing new regulatory approaches that are better attuned to the supervision of risks in increasingly complex and integrated financial markets."

OSFI has taken action to address our audit concerns

OSFI has taken many satisfactory steps to deal with our recommendations.

16.17 OSFI has taken many satisfactory steps to deal with our recommendations. Although a formal evaluation of the regulatory and supervisory framework recommended in the 1995 chapter has not been done, the policy framework has undergone intense scrutiny and review over the last few years. In addition, OSFI's mandate and relationships have been clarified. OSFI has introduced a revised supervisory risk management framework for all federally regulated financial institutions, and reorganized its supervisory and regulatory resources. It has also implemented several human resources initiatives, improved communication with the industry and is in the process of streamlining approval requirements.

Co-ordination between OSFI and CDIC has improved but requires continuous attention

16.18 OSFI and CDIC have taken significant initiatives to improve their working relationship. Given the nature of their respective mandates, their relationship needs to be continuously reviewed to ensure that there are no inconsistencies and unproductive duplication.

Recruiting and retaining qualified employees at OSFI is still a significant challenge

OSFI needs to continue its efforts to become more competitive in the financial sector labour market if it is to fulfil its mandate in evermore challenging circumstances.

16.19 The competition for talent in the financial sector is fierce, especially in Toronto. OSFI needs to continue its efforts to become more competitive in the financial sector labour market if it is to fulfil its mandate in evermore challenging circumstances. As argued by the Superintendent, "OSFI's biggest challenge is still to retain, recruit, train and develop more people who can understand and work with an increasingly complicated financial services industry and the more complex risks to which that industry is exposed."

OSFI's supervisory ability could be under pressure in the short term

Canada's financial services sector is about to undergo profound changes that could affect OSFI's ability to fulfil its mandate.

16.20 With the proposed legislative amendments, Canada's financial services sector is about to undergo profound changes that could affect OSFI's ability to fulfil its mandate. For example, new entrants in the financial system, merging financial institutions or an increased presence by foreign financial institutions could erode OSFI's regulatory and supervisory ability. The International Monetary Fund recently reported, "Growth in the numbers of small-sized institutions could lead to increased numbers of exits of financial institutions in future years, and stretch OSFI's and CDIC's current level of supervisory resources and procedures."

Observations

There is no formal evaluation of the regulatory framework for deposit-taking institutions

16.21 Our 1995 chapter recommended that the government assess the validity of the policy objectives for deposit-taking institutions and evaluate how well the regulatory and deposit insurance system meets these objectives. The Public Accounts Committee supported this recommendation. In its report to the House of Commons, the Committee suggested that the government carry out a comprehensive evaluation of the system for supervising and regulating federally regulated financial institutions.

16.22 The Department of Finance argues that legislative sunset clauses ensure that legislation is periodically reviewed at least every five years. Furthermore, with the MacKay report in 1998, the June 1999 policy paper and the June 2000 legislation introduced in Parliament, the Department argues that comprehensive reviews of Canada's financial sector and regulatory framework have been undertaken in consultation with the industry and with consumer groups.

OSFI's mandate and relationships were clarified

16.23 In our 1995 chapter, we noted the lack of clarity in the mandates of OSFI, CDIC and the Department of Finance. We also discussed the issue of overlapping statutory responsibilities between CDIC and OSFI and its impact on the regulatory burden of financial institutions. In addition, we reported that there was no clear division of responsibilities between OSFI and CDIC and that no accountability framework existed. The chapter recommended that the Department of Finance clarify its role and its responsibility for the functioning of the regulatory and deposit insurance system, in particular the co-ordination of activities of OSFI and CDIC. It also recommended that the mandate of the Financial Institutions Supervisory Committee (FISC) be clarified and its functioning as a mechanism for consultation and exchange of information be reviewed.

The *OSFI Act* was amended in 1996 to include a legislated mandate.

16.24 The *OSFI Act* was amended in 1996 to include a legislated mandate. OSFI developed five objectives that are critical to the successful achievement of its mission: public confidence, safeguard from undue loss, cost effectiveness, competition and high-quality service. OSFI believes that these objectives and a clear mandate better enable the public, financial institutions, and other interested parties to understand its roles and the manner in which it is expected to carry out its responsibilities. The objectives set standards against which OSFI can be held accountable and its performance can be assessed. OSFI has developed and implemented some measurement indicators related to its strategic objectives, and more are planned.

16.25 Measures have been taken to review and update CDIC's Standards of Sound Business and Financial Practices and OSFI is working on new guidelines. The Department of Finance announced in 1999 that the Standards by-laws would remain at CDIC and that they would be updated to streamline the associated administrative process. CDIC and OSFI are collaborating in developing the proposed changes to CDIC Standards, OSFI guidelines and related processes.

16.26 OSFI's and CDIC's working relationship has improved. A guide to intervention for federal financial institutions, published in 1995, describes in detail how OSFI and CDIC are to co-ordinate interventions. In addition, OSFI and CDIC have embarked on significant initiatives to improve their working relationship, such as the establishment of the OSFI/CDIC Liaison Committee and the OSFI/CDIC Working Group on standards and information. The OSFI/CDIC Strategic Alliance is regularly reviewed and is in the process of being revised in light of the proposed changes to financial institutions legislation. These initiatives have resulted in enhanced co-ordination and information sharing between the two agencies.

16.27 OSFI and CDIC need to continue monitoring their relationship to ensure that there is no unproductive overlap. The mandates of OSFI and CDIC are different but they do intersect in certain areas. For example, both agencies have risk assessment functions and capabilities. Parliament has adopted a regulatory system that provides checks and balances and healthy tension between the two organizations. OSFI and CDIC need to monitor their relationship continuously to ensure cost-effectiveness, consistency and proper sharing of information.

16.28 OSFI is addressing the effectiveness of FISC. Although OSFI does not believe that the mandate of the Financial Institutions Supervisory Committee needs to be reviewed, steps have been taken to enhance and broaden the topics of discussion. For example, to make the agenda relevant to more members and to increase attendance at the quarterly meetings, broad financial sector issues are now discussed as opposed to simply exchanging information on problem areas or strategies for dealing with troubled institutions. To increase the Committees' effectiveness, OSFI recently recanvassed members to seek their views on FISC and is to refine the agenda further.

Risk assessment, monitoring and supervisory practices have been reviewed and implemented

16.29 To fulfil its strategic objective of "safeguarding against undue loss", OSFI needs to have strong and effective supervisory practices. Our 1995 and 1997 chapters contained numerous observations on these practices and recommendations for improvements.

16.30 The 1995 chapter recommended that OSFI:

- give priority to strengthening its supervisory practices and reallocate resources between examination and monitoring activities;
- formalize the processes for exercising discretionary powers so that its remedial measures would be timely;
- strengthen the assessment of specialized risk areas such as treasury, securities and management information system; and
- enhance the examiners' risk assessment and management capabilities.

16.31 In the 1997 chapter, we complimented OSFI for developing performance measurement for its regulatory regime. We recommended that OSFI:

- develop a more rigorous system of determining insurance companies ratings;

A reliance-based approach should allow OSFI to concentrate its supervision on activities that are more likely to affect an institution's risk profile, and allow it to better carry out its early intervention mandate.

OSFI has taken a number of initiatives to enhance its supervisory program for financial institutions, pension plans and insurance companies and to better fulfil its safeguarding mandate.

- focus better on key risk areas of life insurance companies;

- review the role of the actuarial staff and improve its relationship with examiners and analysts;

- strengthen its relation with foreign regulators; and

- integrate the monitoring and examination functions of the Pension Benefits Division.

16.32 Since these reports were published, OSFI has taken a number of initiatives to enhance its supervisory program for financial institutions, pension plans and insurance companies and to better fulfil its safeguarding mandate. Some of these measures are still in progress.

16.33 In 1996 the government introduced an early intervention policy. The intervention policy included a legislated mandate for prompt intervention by OSFI and by the financial institutions. This included the power to close institutions in trouble. Guides to intervention for each industry group were also published, clarifying the steps the Supervisor shall take when conditions deteriorate.

16.34 A new supervisory framework was implemented. In 1997 OSFI formed the Regulatory and Supervisory Practices Division to enhance OSFI's risk management methodology. It developed a risk-based supervisory framework to assess the safety and soundness of financial institutions. The new framework, implemented in 1998-99, is designed to enable OSFI to assess the inherent risks associated with a financial institution's significant activities (such as credit risk, operational risk and liquidity risks) as well as the quality of its risk mitigation for those activities (such as internal audit, board oversight, compliance and financial analysis).

16.35 Reliance-based approach should facilitate focus on high-risk activities. OSFI relies on off-site monitoring while on-site work focusses on in-depth evaluations of risks in selected business lines. This approach means that OSFI relies greatly on the work of an institution's internal management and control function. A reliance-based approach should allow OSFI to concentrate its supervision on activities that are more likely to affect an institution's risk profile, and allow it to better carry out its early intervention mandate.

16.36 OSFI reorganized its supervisory and regulatory resources. The organizational distinction between analysis and examination was eliminated in 1998. OSFI integrated the full range of supervisory functions in the new position of Relationship Manager, assigned to every institution. This individual is responsible for maintaining contact with the institution and for establishing the level of intervention based on its financial health.

16.37 OSFI also established a Specialist Support Sector to provide in-depth technical support to the Relationship Manager. It is composed of specialists who focus on selected activities or issues through cross-system reviews and seek to better understand the prudential implications of emerging systemic risks. The Specialist Support Sector is subdivided into eight divisions: accounting, financial analysis and data management, capital markets, capital, compliance, credit risk management, financial services technology specialist, and actuarial.

16.38 A new risk rating scheme is presently being developed. The new rating scheme will replace the CAMEL financial institution rating (capital, asset quality, management, earnings and liquidity) and will be applicable to all federally registered financial institutions. It should be ready for consultation next year. The rating criteria will capture areas such as corporate governance and will be linked to new corporate governance guidelines and the supervisory framework. The scheme will be subject to review and comments by the industry before it is adopted.

16.39 New lines of communications have been established with major foreign regulators. OSFI has entered into several memoranda of understanding with major foreign regulators. Relationship Managers are now contacting these regulators whenever deemed necessary.

16.40 The monitoring and examination functions of private pension plans are now integrated as recommended. OSFI has developed a Risk Assessment System that captures actuarial information. It has also developed an intervention process whereby high-risk pension plans are identified and closely monitored so that problems can be dealt with in a timely manner. The on-site examination function has been transferred from Toronto to Ottawa, where pension supervisors are completing their training in on-site examination. OSFI has introduced regular peer review and quality control processes. It has also established an Intervention Committee within the Pension Division to regularly review problem pension plans.

Improved communication with the industry and streamlined compliance requirement

16.41 In 1995 we recommended that OSFI clarify its governance expectations concerning the board of directors, senior management and internal auditors of regulated institutions. We further recommended that OSFI explore avenues of achieving cost efficiencies to reduce demands on the industry, and that OSFI be more transparent in disclosing its analyses. For example, the CAMEL risk rating was given as an area where enhanced transparency would be desirable.

16.42 In 1997 we recommended that OSFI develop standards of sound business practices for the property and casualty insurance industry and that both OSFI and the Department of Finance review the compliance requirements and consider methods of reducing any negative impact on insurance companies. We also recommended that OSFI strengthen its communication with insurance company officials and that it work to adopt multilateral agreements to enhance the consistency of the federal-provincial pension plan regulatory framework.

16.43 OSFI meets regularly with boards of directors and management. OSFI is now conveying its expectations as part of the supervisory program. It believes that corporate governance requirements are well known and understood. Nonetheless, it will clarify its expectations on corporate governance and best practices with the publication of corporate governance guidelines, soon to be released.

Many of the recent initiatives that OSFI has taken should have a positive impact on its efficiency and compliance costs.

16.44 OSFI has taken measures to improve its efficiency and to reduce compliance costs. Many of the recent initiatives that OSFI has taken should have a positive impact on its efficiency and compliance costs. These initiatives include development of the new supervisory framework, the focus on corporate governance, creation of Relationship Managers, establishment of a Specialist Group, the increased reliance on self-assessment and new internal audit requirements.

16.45 OSFI has introduced user fees for selected regulatory services. The user fees were designed to more fairly allocate costs to the users of those services.

16.46 The legislation before Parliament contains provisions to streamline OSFI's regulatory approval process. A number of transaction applications will need only the Superintendent's approval instead of ministerial approval. Furthermore, under a new notice-based approval process, applications will be automatically approved 30 days following their receipt, unless the Superintendent raises concerns.

A new organizational structure has created opportunities for advancements that allow staff to assume more responsibility and broaden their experience.

16.47 The rating results under the new supervisory framework will be shared with regulated financial institutions. Once the new rating system is developed and implemented, OSFI will be informing institutions of their overall rating.

16.48 OSFI is drafting standards of sound business for the property and casualty insurance industry. OSFI is waiting for CDIC's Standards to be reviewed before going ahead with its own standards to ensure comparability. The new OSFI Standards should be finalized by the end of 2001.

16.49 Overlapping regulatory framework for pension plans is being addressed. The Canadian Association of Pension Supervisory Authorities (CAPSA) has formed a permanent secretariat and a committee to consider a reference model statute that could eventually be adopted by every jurisdiction. OSFI, a member of CAPSA, is actively supporting such a model law.

OSFI has developed a medium-term human resources strategic plan entitled *Your Vision — Our Mission*.

OSFI has improved human resources management practices

16.50 In our 1995 and 1997 chapters, we made a number of recommendations on OSFI's human resources management. In both chapters, we highlighted the need to enhance the skills and competencies of the examination staff. In 1997 we identified other human resources management issues, such as the need to attract and retain qualified staff and the importance of having a framework for human resources management that is responsive to OSFI's changing needs. We also recommended that changes be made to the human resources framework in areas such as classification and compensation, and that the recruitment and retention strategies be based on documented analysis. The Public Accounts Committee reinforced the importance of better human resources management systems.

16.51 OSFI is seeking to become a learning organization. OSFI has developed a suite of training and self-learning programs that respond to its needs in both technical and non-technical areas. Six percent of OSFI's budget is earmarked for training and professional development. OSFI now performs office-wide annual training needs assessments to ensure that the training and learning programs are need-based and timely. Whenever possible, the training courses will include a combination of academic and industry specialists and OSFI expertise in order to ensure that the most current industry-specific issues are being presented. A new organizational structure has created opportunities for advancements that allow staff to assume more responsibility and broaden their experience. In addition, the new Specialist Support Sector has a mandate to provide expertise to the other OSFI sectors through sharing information with front-line supervisors and regulatory staff in support of their activities.

16.52 OSFI has developed a medium-term human resources strategic plan entitled *Your Vision — Our Mission*. The plan provides direction for the continuing evolution of human resources management, with linkages to the Office's strategic plan. OSFI has implemented, or is in the process of implementing, a number of important initiatives to recruit candidates for vacant positions and retain qualified employees. These initiatives include a new classification system, flexibility options afforded to OSFI as a separate employer, the development of competency profiles for all jobs at OSFI, improved compensation and performance pay, and options for staffing and recruiting such as the Career Management Program, which recruits new employees directly from universities and provides them with on-the-job and external training.

16.53 OSFI has also recognized the need to improve its information-reporting capabilities for human resources management. It agrees that sound information on programs relating to human resources management depends on thorough analysis based on comprehensive information. A new human resources management system that integrates information such as retention, vacancy and pay rates was implemented in April 2000.

Revolving Funds in the Parliamentary System: Financial Management, Accountability and Audit — 1995, Chapter 24

Assistant Auditor General: Ron Thompson
Director: John Apt

Background

16.54 A revolving fund is a "revenue re-spending authority." Once Parliament authorizes a revolving fund for an organizational unit of the government, the managers of that unit can re-spend its revenues on an ongoing basis for approved purposes and within agreed limits. For the year ended 31 March 1999, there were 17 revolving funds with approximately $1.2 billion in revenues and expenses.

A Guide on Revolving Funds and revised policy have now been issued.

16.55 In our 1995 chapter, we recommended that the Treasury Board Secretariat strengthen its policies governing revolving funds. The chapter noted that the Secretariat needed to improve its oversight of organizations that operate revolving funds. The Secretariat agreed to take the recommendations into account when the next revisions to the revolving fund policy were made.

Scope

16.56 Our follow-up consisted of a review of actions taken by the Treasury Board Secretariat in response to our recommendations. We held discussions with Treasury Board staff, reviewed the Guide on Revolving Funds issued in December 1997, and reviewed the revised policy and related documents. Our work was designed to provide a moderate level of assurance that our recommendations have been addressed. We did not specifically examine the revolving funds or the practices of the departments involved.

Conclusion

16.57 Progress on addressing the recommendations of our November 1995 chapter has been slow. For example, the Treasury Board Secretariat issued the draft Guide on Revolving Funds in December 1997 and it remains in a draft format. The revised Policy on Special Revenue Spending Authorities, which includes the policy on revolving funds, was approved for distribution in June 2000.

16.58 Nevertheless, the use of the Guide by revolving fund management and implementation of the revised policy substantially address the recommendations we made in 1995.

Observations

16.59 The table in Exhibit 16.1 provides our 1995 recommendations and the Treasury Board Secretariat response. A summary of the current status of these recommendations is presented in the following paragraphs.

16.60 Additional guidance on relationship between revolving fund and host department. Treasury Board policy requires departments to obtain Treasury Board approval of the roles and responsibilities of the Deputy Head and the revolving fund management when a revolving fund is established. This agreement should be reviewed every three to five years as part of the mandate and viability review to ensure that it continues to be appropriate. The draft Guide on Revolving Funds states that the relationship between the unit operating a revolving fund and the host department should form part of the framework document in order to link accountability to a sense of strategic direction and provide stability.

16.61 Strengthened criteria for granting and reviewing revolving funds. The general criteria for establishing a revolving fund are listed in Appendix B of the Treasury Board policy. The draft Guide provides criteria and issues to be considered when establishing a revolving fund, as well as those to be considered when assessing the continuing need for the revolving fund. The mandate and viability of revolving funds are to be reviewed every three to five years. Mandate and viability reviews have been requested from all organizations that operate revolving funds. These reviews are to be completed by May 2001.

16.62 Adoption of Generally Accepted Accounting Principles. The policy requires that financial statements be prepared in accordance with Treasury

Exhibit 16.1

Recommendations of Our 1995 Chapter on Revolving Funds

November 1995 Chapter 24	
Office of the Auditor General Recommendations	**Treasury Board Secretariat Response**
24.57 Treasury Board should provide additional guidance in its policies, or in some other appropriate vehicle, on the general organizational relationship between the unit operating a revolving fund and the host department.	Within the existing government framework, consisting of legislation, regulations and Treasury Board policies, this recommendation will be taken into account when the next revisions to the revolving fund policy are made.
24.65 Treasury Board should strengthen the criteria for granting revolving funds and for periodically assessing and reaffirming their continued appropriateness.	This recommendation will be taken into account when the next revisions to the policy are proposed.
24.70 Treasury Board should adopt Generally Accepted Accounting Principles as the standard financial accounting measure for all revolving funds.	The Treasury Board Secretariat recognizes the importance and usefulness of Generally Accepted Accounting Principles, and this recommendation will be taken into account when the next revisions to the policy are proposed.
24.77 Treasury Board should require that units using revolving funds adopt a form of annual reporting that includes financial statements, performance reporting using an established available framework and a comprehensive "Management Discussion and Analysis" section. These reports should be submitted to Treasury Board and be available for public scrutiny.	The Treasury Board Secretariat recognizes the usefulness of this recommendation, and it will be given full consideration when the next revisions to the policy are proposed.
24.84 Treasury Board should issue guidelines for independent validation of disclosed information on revolving funds that calls attention specifically to compliance with authority as well as to the fairness of the financial statements, and that identifies who carried out the validation.	The Treasury Board will take this recommendation into account when the next revisions to the policy are made.
24.93 Treasury Board Secretariat should consider alternative strategies and approaches for oversight of revolving funds.	Independent of the funding mechanism chosen for an activity, the government considers and implements alternative strategies and approaches for oversight as appropriate. Examples are provided in the recent publication "Framework for Alternative Program Delivery".
24.99 Treasury Board staff should assess how best to build the appropriate capacity needed to support better use of revolving funds and accrual accounting.	The Treasury Board Secretariat agrees with this recommendation, and had already taken steps prior to the commencement of the audit to achieve these ends.

Board Secretariat accounting policies based on Generally Accepted Accounting Principles (GAAP).

16.63 Strengthened annual reporting. The policy requires that financial and operational performance of the revolving fund be assessed relative to the business plan every three to five years. The draft Guide provides guidance on preparation of the framework document and business plan, including performance measures and targets and reporting requirements. It also describes each of the required financial statements.

16.64 Independent validation of disclosed information. The policy requires financial statements to be audited to assess compliance with the Treasury Board Secretariat accounting policies. The draft Guide provides a model, objective and scope in Sections 7040 through 7042.

16.65 Alternative strategies for oversight. Departments will be required to submit to Treasury Board, with the Annual Reference Level Update, a multi-year business plan that will include planned use of their drawdown authority, a long-term capital plan if applicable, and the rates to be charged in the next fiscal year. In addition, the results of the mandate and viability reviews will be analyzed by the Treasury Board Secretariat and recommendations will be made as appropriate. This measure will assist in ensuring appropriate Treasury Board oversight of organizations that operate revolving funds.

16.66 Capacity to support better use of revolving funds and accrual accounting. Training for program analysts was planned for this summer. The Treasury Board Secretariat recognizes that this type of training is an ongoing requirement.

Canada Labour Relations Board — 1997, Chapter 26

Assistant Auditor General: Jean Ste-Marie
Director: Sue Morgan

Background

16.67 We reported to Parliament on the Canada Labour Relations Board (CLRB) in December 1997. The report focussed on travel expenditures, allowances, and benefits reimbursed to the Chair and members of the CLRB. The report also made recommendations to address financial control problems.

16.68 We observed that some of the CLRB's financial practices would not bear the closest public scrutiny. We reported that there were no time frames for former Board members to complete cases, and questioned the cost effectiveness of their open-ended appointment.

16.69 We also commented that the CLRB's travel and hospitality rates for its Governor in Council (GIC) appointees were significantly higher than the rates applicable to public servants.

16.70 We made specific recommendations affecting the CLRB and government-wide recommendations affecting other entities that have authority to establish their own travel and hospitality policies.

16.71 Subsequent to our audit, Parliament passed Bill C-19, which came into force 1 January 1999. This legislation was introduced to modernize and improve the collective bargaining process for federally regulated industries. The Bill established the Canada Industrial Relations Board (CIRB) as a representational, quasi-judicial tribunal responsible for interpreting and applying the Canada Labour Code. The CIRB is the successor to the CLRB.

16.72 In response to our audit, the Comptroller General issued a letter to deputy heads and senior financial officers about the financial management responsibilities of Governor in Council appointees. The Treasury Board Secretariat also revised the wording of the Special Travel Authorities. The government issued an order-in-council directing that entities with the authority to establish their own travel and hospitality policies be guided by Treasury Board Special Travel Authorities and Hospitality policy.

16.73 This follow-up report focusses on the corrective action taken by the CIRB and the government on our recommendations in the 1997 chapter.

The Canada Industrial Relations Board is the successor to the Canada Labour Relations Board.

Scope

16.74 We reviewed the government's progress since December 1997 in improving the accountability of Governor in Council appointees for their travel and hospitality expenses.

16.75 We examined travel and hospitality expenses of the CIRB Chair and the members. We also examined the CIRB's performance levels, the assignment of cases to former Board members and the per diem amounts paid to the former members.

16.76 We reviewed actions taken by the Treasury Board Secretariat and the Privy Council Office. In addition, we reviewed the performance reports of the six entities that have established their own travel and hospitality policies (the same six entities featured in our 1997 chapter).

Conclusion

16.77 Our follow-up work indicates that the CIRB has made progress in addressing the recommendations that dealt with the financial control problems. To a large degree, it is using Treasury Board rates for the Chair's and the Board members' travel and hospitality expenses.

16.78 However, the CIRB paid its former members significant per diem amounts for completing their cases. As well, the continued appointments of former members are still open-ended unless the Chair exercises his discretion to withdraw and reassign cases. On average, it was taking longer to hear and to process cases in the three-year period.

The Canada Industrial Relations Board has incorporated most of the Treasury Board rates in its policies.

16.79 The government as a whole has not taken adequate action to address our concerns about the need to improve the accountability framework governing travel and hospitality expenses of senior Governor in Council appointees.

Observations

CIRB's travel and hospitality policies

16.80 Under its new legislation, the CIRB has the same authority to establish its own travel and hospitality policies as the CLRB had. As part of its policies, the CIRB has incorporated most of the Treasury Board rates for the Chair and the Board members.

16.81 The CLRB had 14 full-time Governor in Council appointees. As the deputy head, the Chair (GIC-10) of the CLRB had "full discretion" over his travel expenses. The Chair claimed actual expenses. The five Vice-Chairs (GIC-9) and eight members (GIC-5) were reimbursed for their travel expenses using a per diem system that required no receipts.

The Canada Industrial Relations Board paid its former members a significant amount in per diem expenses.

16.82 At the time of our follow-up review, the CIRB had 11 full-time Governor in Council appointees: the Chair (GIC-9), four Vice-Chairs (GIC-7), and six members (GIC-5). In May 2000, the Governor in Council appointed an additional Vice-Chair and six part-time members in the regions. The Chair, at level 9, retains discretion under the Treasury Board's Special Travel Authorities. However, the CIRB's travel policy applies to all Board members, including the Chair. The Vice-Chairs and the other members do not have discretion over their travel expenses. They are required to follow the CIRB's travel and hospitality policies, which are similar to the Treasury Board's policies.

16.83 Our review of a sample of travel and hospitality expenses of Board members and the Chair indicates that the CIRB is using the Treasury Board rates to a large degree.

Continued appointment of former Board members in the transition period

16.84 In our 1997 chapter, we recommended that the government take the necessary steps to reintroduce legislation to clarify authority and responsibilities within the Board. Bill C-19 provided the Chair of the CIRB with control over assignment of cases and clarified the authority and responsibilities within the Board.

16.85 In 1997, we questioned the CLRB's use of former members to hear cases long after their full-time terms had expired. We recommended that the government limit the continued appointment of former Board members to a reasonable period.

16.86 When the new legislation came into force in January 1999, it provided for the former members to complete the cases they had heard while on the CLRB. The former members were paid a per diem rate set by the Governor in Council. We observed that the continued appointments of former members are still open-ended — that is, with no termination date. However, in order to terminate the arrangements with the former members, the Chair would have to exercise a transitional provision of Bill C-19, which would provide him with the discretion to withdraw and reassign any cases not disposed of within one year following the legislation's coming into force.

16.87 Effective 1 January 1999, the CIRB inherited 542 cases from the CLRB; 408 of these cases were reassigned to CIRB members and 134 cases remained with the former members. As at 31 March 2000, there were 43 unresolved CLRB cases. In May 2000, the CIRB advised us that there were only 10 unresolved CLRB cases. The former Board members collectively disposed of 91 cases during January 1999 to March 2000.

Payment to former members was the major transition cost

16.88 Under normal circumstances, tenures of Board members are staggered to ensure continuity in the Board's operations. However, with the implementation Bill C-19 on 1 January 1999, the new CIRB was created and the CLRB abolished, ending the terms of all the Board members. This led to one-time transition costs of $1.7 million. The CIRB told us that, with the new Board only partially staffed, it had no choice but to have certain former members return to handle the CLRB's outstanding cases.

16.89 The CIRB paid its former members $895,000 in per diem expenses and $43,000 in travel expenses for the period of January 1999 to March 2000. From April 1997 to December 1998, the CLRB had paid $53,000 in per diem expenses and $12,000 in travel expenses to its former members. The travel expenses do not include prepaid airfare costs.

16.90 The payment to the former members was the single biggest expenditure of the CIRB's $1.7 million in transition costs. In 1997, we reported that the CLRB had spent about $1.7 million in per diem expenses during the eight years between April 1989 and March 1997.

Overall decline in performance levels

16.91 There was an overall decline in performance levels. We looked at the three-year period but did not distinguish between files processed by the CLRB and the CIRB. We note that the total number of completed cases increased in 1999-2000 compared with previous years. The CIRB disposed of 852 cases in 1999-2000; 605 cases had been disposed of in 1998-99 and 626 cases in 1997-98. On average, however, it was taking longer to hear and to process cases in the three-year period than it did in the preceding years. Exhibit 16.2 shows increasing case processing times from 1997-2000. The CIRB told us that it has made progress in reducing the processing times for cases received after 1 January 1999.

16.92 The CIRB advised us that the following factors negatively affected processing times:

- extraordinary increase in workload resulting from new cases;
- delays in appointing new members to the CIRB; and
- difficulty in re-assigning cases already heard by former CLRB Vice-Chairs.

16.93 Our review of the CIRB's workload indicates that the growing backlog of cases is due to a significant increase in new cases. The CIRB told us that the workload increase stems from

Exhibit 16.2

Canada Industrial Relations Board Case Processing Times — 1997-2000

	1997-98	1998-99	1999-2000
Days to process case **without** public hearings	129	150	176
Days to process case **with** public hearings	330	560	403

Source: CIRB performance information major structural and technological changes being experienced by clients such as the airline, telecommunications and broadcasting industries. The CIRB advised us that it will be implementing more aggressive administrative steps, such as alternative dispute resolution, to handle the increasing workload.

Accountability by senior Governor in Council appointees

16.94 In 1997, we recommended that the Privy Council Office and the Treasury Board Secretariat clearly explain to the Governor in Council appointees the role of deputy head and senior financial officer under *the Financial Administration Act* and Treasury Board regulations and policies.

16.95 In August 1999, the Privy Council Office issued a booklet called "A Guide Book for Heads of Agencies — Operations, Structures and Responsibilities in the Federal Government." It provides an overview of government operations and the role of the deputy head.

16.96 In response to our audit, the Comptroller General issued a letter in December 1997 to all deputy heads and senior financial officers about their respective financial management responsibilities under the *Financial Administration Act*. The letter reiterated the Treasury Board's comptrollership policy requirement that the senior financial officer consult the Deputy Comptroller General when the actions of the deputy head would pose a financial risk or violate government policy.

16.97 The Treasury Board's Policy on Responsibilities and Organization for Comptrollership does not adequately deal with senior Governor in Council appointees whose travel and hospitality expenses deviate from Treasury Board policies. The comptrollership policy relies on the senior financial officer, a subordinate to the deputy head, to notify the Deputy Comptroller General about financial management irregularities involving the deputy head.

16.98 We asked the Treasury Board Secretariat about any follow-up action that it had taken since the December 1997 letter. The Secretariat advised us that no follow-up action was required, because the onus to seek assistance and advice rests with the senior financial officer.

16.99 We noted in our 1997 chapter that conflicting phrases such as "full discretion" and "general principles" created confusion and the government should clarify "the general principles." Consequently, the Treasury Board Secretariat changed the phrase "full discretion" to "discretion" in the Special Travel Authorities.

16.100 The revised Special Travel Authorities state, "heads of departments and agencies have discretion over commercial accommodation selected, telephone calls, [and] meals and incidentals in excess of the per diems, based on receipts." The Special Travel Authorities elaborate on "discretion" in the following manner:

> This discretion should be exercised with prudence and probity, mindful that all expenditures must further government objectives. Although specific circumstances may warrant exceptional expenses, the basic norm should be comfortable and convenient, but not excessive. A benchmark may be found in the provisions of the Treasury Board Travel Directive.

16.101 The Special Travel Authorities emphasize the responsibility of senior Governor in Council appointees for their own travel and hospitality expenses. However, they are still too vaguely worded, leaving the senior Governor in Council appointees to determine their own standard for "the basic norm." The

Treasury Board Secretariat did not clarify the "general principles." Accordingly, we conclude that the policies governing senior Governor in Council appointees' travel and hospitality expenses have essentially not changed.

Treasury Board policies for travel and hospitality expenses of senior Governor in Council appointees have essentially not changed.

Order-in-council introduced in 1997

16.102 In 1997, we recommended that the government propose legislation to Parliament containing guidelines for travel and hospitality expenditures by entities that have the authority to establish their own policies. We reported that 36 of the 52 entities we consulted have the authority to establish their own travel and hospitality policies, which can vary from Treasury Board policies.

16.103 In response, the government introduced an order-in-council in December 1997. It directed that organizations with the authority to establish their own travel and hospitality policies be guided by Treasury Board's Special Travel Authorities and Hospitality Policy. This direction does not apply to judges and to Governor in Council appointees in Crown corporations.

16.104 An order-in-council such as the one made in December 1997 does not override provision for travel and hospitality authority in an entity's enabling legislation. Thus, for Governor in Council appointees in entities that have travel and hospitality authority, the order-in-council merely provides guidance.

Monitoring of travel and hospitality expenses

16.105 Although the majority of Governor in Council appointees are in entities that have authority to establish their own policies, the Treasury Board Secretariat does not monitor their travel and hospitality expenses.

16.106 There are about 360 full-time Governor in Council appointees in the 52 boards, agencies and commissions. Of these appointees, 339 are in 36 entities that have the authority to establish their own policies. For the majority of the Governor in Council appointees, Treasury Board policies and the order-in-council serve only as guidance.

16.107 In view of the open and varying authority framework governing travel and hospitality expenses of Governor in Council appointees, we believe that more concrete steps are needed to monitor their practices. Although the government has moved to clarify financial management responsibilities, in our opinion the Treasury Board Secretariat has not taken adequate measures to improve the accountability of Governor in Council appointees for their travel and hospitality expenditures.

Reporting to Parliament

16.108 In 1997, we commented that 6 of the 36 entities with authority to do so had established their own travel and hospitality policies. We recommended that those entities report to Parliament on their policies and the resulting additional costs in comparison with Treasury Board policies for public servants.

16.109 Two of the six entities subsequently reported to Parliament in 1998 and 1999 that they had their own policies. A third entity did not report to Parliament because, in the entity's opinion, the difference between its own policy and the Treasury Board policies was small. The three remaining entities advised us that they had been unaware of any requirement to report to Parliament.

The Treasury Board Secretariat does not monitor travel and hospitality expenses of Governor in Council appointees.

16.110 The reporting requirement was outlined in part in the December 1997 letter of the Comptroller General to deputy heads and senior financial officers. The Treasury Board Secretariat indicated to us that reporting to Parliament is now an ongoing requirement.

Department of National Defence — Equipping and Modernizing the Canadian Forces — 1998, Chapter 3

Assistant Auditor General: David Rattray
Principal: Peter Kasurak

Background

16.111 In 1998 we audited the capital equipment program of National Defence, which accounts for spending of $1.4 billion a year. We assessed how well the Department was maintaining the modern, multi-purpose forces required by the government's policy. According to departmental business plans, the Department would require $11 billion in capital funds over the next five years but would receive only $6.5 billion, resulting in a $4.5 billion shortage.

National Defence has taken steps that substantially meet our recommendations and those of the Public Accounts Committee.

16.112 Officials told us they were taking action but "hard choices may have to be made." The Department was working on a long-term examination of the Canadian Forces, including capabilities, future force size, force development priorities and new ways to support operations. Force reductions and reduced military readiness were possible outcomes of the Department's planning.

16.113 Planning was hampered by a lack of adequate policy guidance, clear priorities and performance information. We also found that other countries were doing better at linking capital spending to policy objectives and were providing more information to their legislatures.

16.114 The Public Accounts Committee agreed with our findings and recommended that the Department improve its planning and also provide Parliament with a comprehensive defence review and assessment, capital acquisition plans and relevant indicators in its annual Departmental Performance Report.

Scope

16.115 We followed up on our recommendations and those made by the Public Accounts Committee. We reviewed budget and force structure review files and interviewed departmental officials responsible for the capital budget.

Conclusion

16.116 The Department has made significant progress in addressing its lack of plans and priorities and linkages between policy and its force structure. However, officials estimate that each year the Department is still about $750 million short of the amount needed to modernize and maintain readiness. The "hard choices" referred to in 1998 have been identified but not all of them have been made.

16.117 The government rejected the Public Accounts Committee's recommendation that Parliament be provided with more information on whether the capital equipment program was succeeding in meeting defence capability goals.

Observations

The capital budgeting and force planning processes have been improved

16.118 The Department has taken steps to improve its processes for capital equipment planning and budgeting. These steps substantially address our recommendations and those of the Public Accounts Committee that the Department complete its force employment scenarios, force development framework and strategic assessments. Specifically, we note the following progress:

- Force employment scenarios describing the possible use of the Canadian Forces have been completed and are being used to screen individual projects and requirements and to plan the most recent force structure adjustments.

- A much more disciplined force development framework has been designed and put in place. This framework is based on a "Canadian Joint Task List", which is an inventory of individual military tasks that the various force employment scenarios may require. A Senior Management Oversight Committee, chaired by the Deputy Minister and the Chief of the Defence Staff, has approved relative levels sought for the top-level capabilities. This guidance will allow a more rational and transparent basis for funding some projects in preference to others. It also provides explicit links back to policy goals. In May 2000, the duties of the Senior Management Oversight Committee were taken over by the Joint Capability Requirement Board, chaired by the Deputy Minister, Chief of the Defence Staff or the Vice Chief of the Defence Staff. The change made this process a formal part of the Department's management process.

- The Department has conducted its own analyses of the total budget requirements generated by both current policy goals and its existing force structure. These analyses largely confirm our 1998 findings and provide a much sounder basis for planning.

- The Department has announced that it intends to rethink its force structure. In Shaping the Future of Canadian Defence: A Strategy for 2020 published in June 1999, the Department stated that it had a five-year target for designing a "viable and affordable" force structure based on a modernization program allocated a minimum of 23 percent of the Defence budget. As a first step, the current Defence Planning Guidance 2000 has set an interim goal of 21 percent by April 2004.

Parliament has not been provided with a full appraisal of the capability of the Canadian Forces

16.119 We recommended that the Department provide to Parliament sufficient information on military capabilities, performance and resources so that it could better review the Department's Estimates. The Public Accounts Committee recommended that the Department include in its annual Performance Report a comprehensive defence review and assessment and provide indicators that would show how well the capital acquisition plan met defence capability goals.

16.120 The government rejected these recommendations as either impractical, as in the case of an annual comprehensive statement, or already addressed by various public documents.

The government rejected recommendations to tell Parliament more about the capability of the Canadian Forces.

16.121 None of the documents that the Department cited provide a great deal of information on the state of the Canadian Forces. The Department's 1999 Performance Report provides very little quantified data on whether the Canadian Forces have met military readiness and performance standards. Only vaguely worded statements are provided, such as "we have exceeded expectations," "the Department of National Defence and the Canadian Forces are working hard to meet the challenges they are currently facing," and ". . . even with additional resources, Defence will have to continue to make hard choices. . . . The Canadian Forces cannot be all things to all people. Priorities must be set and decisions must be made." The Chief of the Defence Staff's Annual Report on the State of the Canadian Forces does not assess the overall state of equipment and provides only a list of new equipment received. According to the Report on Plans and Priorities - 2000, " . . . the Canadian Forces are now more combat capable than they were ten years ago." This statement is not fully explained, but appears to rest on the fact that some new equipment was received.

A budget shortfall still exists.

16.122 The Department continues to develop performance indicators for reporting to Parliament; however, according to the Defence Planning Guidance 2001, they will not be completed until 2001. Officials told us that the Department would provide Parliament with a "snapshot" appraisal of Canadian Forces capabilities in the next reporting period.

Documents show a major decline in capability, a continuing budget crisis and imminent restructuring of the Canadian Forces

16.123 Documents indicate that the budget crisis is continuing to place the Canadian Forces under severe stress and that cuts affecting force structure and readiness are continuing. The publicly available Defence Planning Guidance 2000 and 2001 announced several changes to force structure:

- The Navy will lose the operating budget for two KINGSTON class maritime coastal defence vessels, for which the acquisition payments were just completed. The admirals on the East and West coasts may continue to operate these two vessels if they can find funds internally. The Navy will also retire two mine sweeper auxiliaries.
- The Air Force has removed 8 of its 14 Challenger jets and will remove its Silver Star aircraft from service by 2001-02. This will suspend the Canadian Forces' ability to conduct its own electronic warfare training until contract support can be secured. In addition, two DASH-8 aircraft were declared surplus.
- The Department called for a 10 percent reduction in infrastructure from its component parts.

16.124 The business plans of the individual services for the 2000 planning year indicate that additional reductions are planned. The Air Force faces the largest cuts: the CF-18 fleet may be reduced from 122 to 80 aircraft and, overall, the Air Force will shrink from 460 aircraft to 257. The Army has not yet determined how it will restructure itself, but it could also face significant reductions in its order of battle. The Navy points to problems in maintaining fleet readiness and intends to adopt a new readiness policy.

16.125 A review of the Department's budgetary situation concluded in November 1999 that the Department had lost all flexibility to cope with cumulative resource pressures and was "out of manoeuvering room." Defence planners estimated that the Department would require over $1 billion annually in additional funding to operate even a smaller force while modernizing, revitalizing infrastructure and maintaining readiness. The federal Budget for 2000 added $400 million to the first year of the three-year planning period, and funds will grow to about $600 million in the final year. A significant shortfall therefore remains.

16.126 In summary, there is a need to provide Parliament with a more complete picture of the capabilities of the Canadian Forces.

Department of National Defence — Buying Major Capital Equipment — 1998, Chapter 4

Assistant Auditor General: David Rattray
Principal: Peter Kasurak

Background

16.127 In 1998 the Department of National Defence was responsible for capital equipment programs costing about $6.5 billion over the next five years. Our audit focussed on analysis of requirements and options; risk management; test and evaluation; project management, monitoring and control; and the implementation of best practices in project management. We audited six major capital projects with a total value of $3.3 billion.

16.128 We found several shortcomings in how the Department managed major equipment projects. Management did not conduct adequate analyses to justify its spending decisions, and options analyses were poorly done. Only one project out of six met our expectations for risk management. Test and evaluation processes were satisfactory, but commercial off-the-shelf equipment was sometimes not tested under actual military conditions. As a result, deficiencies appeared after the equipment was in service. The Department lacked an implementation plan for renewal of the capital acquisition process.

16.129 The Public Accounts Committee held hearings on our report and recommended that the Department strengthen its process for assessing requirements and options, conduct operational testing, particularly of off-the-shelf equipment, and develop and implement a framework for reporting project performance to senior management.

Scope

16.130 We followed up on our recommendations and those made by the Public Accounts Committee. We interviewed the managers responsible and reviewed documentation. We also reviewed all internal audits of capital projects completed by the Department since the time of our audit.

16.131 In addition, we reviewed four newer capital projects to determine if improvements made by the Department in its management processes were being implemented. The projects we selected were Clothe the Soldier, Search and Rescue Helicopter, Maritime Helicopter and the Submarine Capability Life Extension project. We did not audit these projects fully against our original criteria, nor did we attempt to form an opinion on the overall management of these four projects.

The Department has taken action on our recommendations.

Conclusion

16.132 The Department has taken action to reform its management systems in line with our recommendations and those of the Public Accounts Committee. The Department has gone substantially beyond its original responses to us and to the Committee.

16.133 Improvement in the management of individual projects is evident, but is not yet universal.

Observations

Analysis of requirements and options is improving

16.134 In 1998 we reported that three of six projects audited did not meet standards for analysis of requirements and five of six did not meet standards for options analysis. As a consequence, we found that the equipment purchased often did not meet the actual needs of field forces.

16.135 The Department has taken steps to improve its analyses. It has created an intranet site for its Materiel Acquisition and Support Desktop. This document includes detailed guidelines for developing a statement of requirements and some guidance on how to conduct an options analysis. The guidelines for the statement of requirements are based on those of the Project Management Institute and incorporate other improvements such as specifying the use of the Department's standard conflict scenarios.

16.136 Senior management has become much more involved in determining fundamental requirements through the use of the Joint Capability Requirement Board. New tools, such as conflict scenarios and the Canadian Joint Task List, are now used to assess options.

16.137 We found evidence of improvement in the Clothe the Soldier and the Maritime Helicopter projects. According to an internal audit, the statement of requirements for the Clothe the Soldier project was complete, valid and reviewed by users. The statement of requirements for the Maritime Helicopter is well documented and is based on a series of operational research studies.

16.138 However, not all projects showed improvement. The Submarine Capability Life Extension project, through which the Department will purchase four used British submarines for about $800 million, was weak in several ways. The Submarine statement of requirements was completed only a month after our audit report was tabled to Parliament. The statement is incomplete, as it does not define the requirement stated in the 1994 White Paper for submarines to deploy as part of a Canadian Task Group. Although the statement places heavy stress on surveillance in Canadian waters for fisheries patrol and counter-smuggling operations, the utility of submarines for this task is poorly substantiated. The option of using long-range patrol aircraft for surveillance was not examined.

Risk management processes have been strengthened

16.139 In its original management response to our audit, the Department did not make any specific commitment to improve risk management, although officials told us that improvement in this area was an integral part of the overall reform initiative. Nevertheless, the Department has made a series of improvements that should greatly improve its capacity to reduce its risk:

- The Treasury Board Risk Management Guide has been adopted and incorporated in a new three-day extension to the Department's project management course.
- A risk management template has been included in the Materiel Acquisition and Support Desktop on the Department's intranet.
- Management teams of major projects will receive "just-in-time" risk management training.
- Reviews by the Directorate of Business Change Management and internal audits will be conducted early in the life of major projects to assess risk management plans and recommend improvements.

The risk management of individual projects is slowly improving. There is still a tendency to underestimate risk. Internal audit noted the arbitrary downgrading of assessed risk in reports to senior management.

16.140 In one case, the Submarine Capability Life Extension project, risk analysis was incomplete. Officials told us that limited access to the boats in the early phases of the project reduced their ability to do a full risk analysis. The project team is now completing a risk management plan for the Canadianization of the submarines.

16.141 The highest level of improvement was noted in the risk management plan for the Search and Rescue Helicopter. This project's plan describes its risk management process, which is supported by a database. Working-level managers identify risks and table them at a Risk Management Committee chaired by the Project Manager. The Committee reviews the most significant risks, reports higher-level risks to senior management and ensures that the Project Profile and Risk Assessment is continuously updated. The Department has identified this as a best practice and intends to transfer it to additional projects.

16.142 In the case of the Electronic Support and Training Systems project, poor risk assessment and the mismatch between the capital acquisition program and the funds available contributed to losses beyond those reported in our 1998 audit. The case is more fully described in Exhibit 16.3.

Some action has been taken to improve test and evaluation

16.143 Our report and that of the Public Accounts Committee both called for increased test and evaluation, especially of off-the-shelf equipment. Equipment suitable for commercial use or other militaries might not be suitable for the Canadian Forces.

16.144 As with risk management, the Department made no specific commitment to improve test and evaluation in response to our original recommendation and that of the Public Accounts Committee. The Department said only that it would take action on the existing practices our audit had found inadequate. Subsequently, officials told us that the Department has taken several steps to improve test and evaluation:

- Test and evaluation is being integrated with risk management, and project managers are required to address test and evaluation as part of their overall risk management strategy.
- Integrated Project Teams are attempting to integrate contractor and departmental test and evaluation processes.
- The Department is investigating other reform initiatives to minimize equipment performance deficiencies.

16.145 We found additional evidence that off-the-shelf purchasing includes inherent risks that require a strong test and evaluation program to minimize them. The Clothe the Soldier project, aimed at providing combat clothing and protective equipment to ground troops, was at first based on a fast-track, purchase off-the-shelf approach. However, a well-devised test and evaluation program determined that much commercial or foreign military equipment would not meet requirements. While this project has incurred both time and cost overruns beyond original estimates, the Department's re-evaluation of its requirement should be regarded as good management in that a mistaken decision was overturned and value for money was preserved.

The $200 million Electronic Support and Training project failed to meet original requirements and was abandoned when complete.

16.146 According to an internal audit, an off-the-shelf vehicle-launched grenade, which was purchased for about $750,000 without adequate testing for the intended use by the Canadian Forces, has not been used due to concerns about the safety and suitability of a munition potentially lethal to the troops using it. The Department needs to reappraise its position that off-the-shelf equipment is inherently less risky to purchase than developmental types.

Senior departmental management is better informed

16.147 We recommended that the Department enforce its requirement that all projects use the Cost Schedule and Performance Management Standard to report to senior management. The Public Accounts Committee made a similar recommendation. National Defence, in co-operation with Public Works and Government Services Canada, has begun to develop a new capital project reporting system. This system exists in prototype now and is scheduled to be fully implemented by the end of 2000. At present, project reports are somewhat uneven in quality, but the better ones provide adequate information.

Exhibit 16.3

Electronic Support and Training Systems Project

The Electronic Support and Training Systems project was intended to develop, procure and install equipment necessary for the Canadian Forces to conduct electronic warfare training for the Navy, Army and Air Force. The total estimated cost of the project was $203 million. The project began in 1988.

As our audit noted, internal project documentation suggested that the project faced technical risks with a high probability of occurrence. However, National Defence had reported to the Treasury Board that the risk of exceeding cost and falling behind schedule was a low probability and the risk of failing to meet project expectations was a low to medium probability.

At the time of our audit, elements of the project had cost overruns totalling $22 million. Officials told us that they would deal with these overruns by adopting a non-conventional in-service support approach. We also reported that the project was 22 months behind schedule.

However, in late February 1998, before our audit report was finalized, a Senior Review Board decided to substantially reduce the scope of the project. According to officials, the installation of high-powered jamming equipment into a small commercial business jet produced unforeseen technical challenges. Efforts to solve these problems depleted the budget, and further work required to resolve system processor and integration problems created an excessively high technical risk that would not be reduced even with additional funding. A decision was therefore made not to install electronic countermeasures, electronic support systems and the system processor in the Challenger jets. This meant that the development and purchase costs of this equipment and engineering costs of the attempted installation were written off. In addition, the partially completed aircraft no longer met the requirements of the Canadian Forces.

Other components of the project, including fitting the Challenger jets with communications-jamming and chaff-dispensing equipment, were successfully completed. In addition, 19 radar-jamming, chaff-dispensing and threat simulation pods and modifications to 10 CE-133 T-bird aircraft were also completed.

In August 1999, the Department announced that the partially completed Challenger aircraft would be declared surplus in April 2000 and that the T-birds would be withdrawn from service by the end of fiscal year 2001-02. This action was taken because of the Department's overall shortage of funds and inability to support its force structure. Much of the investment has therefore been written off, leaving the Canadian Forces without the planned electronic warfare capability provided internally. The Department may recoup some of its losses through the sale of the equipment or its use by a contractor.

The Department's broader force structure decision to retire all its T-bird aircraft and Challenger jets used for electronic warfare training and medical evacuation, and to write off its investment in favour of private sector outsourcing was made, in part, because:

- inadequate risk management resulted in the Department's inability to complete the project as planned; and
- inadequate budgetary management led to the acquisition of equipment that proved to be unaffordable to operate as soon as it was completed.

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- **inadequate risk management resulted in the Department's inability to complete the project as planned; and**
- **inadequate budgetary management led to the acquisition of equipment that proved to be unaffordable to operate as soon as it was completed.**

16.148 The Department has also instituted two additional means of monitoring project performance:

- Annual reviews of major projects by the Directorate of Business Change Management are aimed not only at assessing the management of projects, but also providing assistance to improve any weak areas.
- Early and "quick time" reviews are done by the Chief Review Services.

Overall, management is receiving more and better information on the progress of major capital projects than at the time of our audit.

The Department is slowly improving the capacity of its people

16.149 In 1998 we noted that National Defence did not have an adequate plan to ensure that it had people with the right skills in the right place to manage major capital equipment projects. We noted, however, that it did have a civilian procurement officer development program in place.

16.150 Officials told us that the required human resources plan will be completed by the fall of 2000. The Materiel Group is recruiting 13 developmental civilian procurement officers, some with Master's degrees, and about five junior engineers for development. For military engineers expected to lead equipment management teams, including capital acquisition projects, equipment program management and leadership training has been established as a qualifying course to achievement of Major rank. In addition, the Materiel Group has identified performance requirements or competencies for procurement careers, and improved training programs and tools will be piloted in the fall of 2000.

The Department is continuing improvements in project management

16.151 We suggested that the Department develop a more rigorous approach to improving project management by having a plan, selecting pilot projects to test innovations and recording the results against pre-set objectives. The Department initially followed this approach but was forced to abandon it as it was too labour intensive. The Department has continued to improve project management by concentrating its resources on reviewing and providing direct assistance to its largest and highest-risk projects. It is also participating in the Federal Procurement Reform project led by the Treasury Board Secretariat.

Chapter 17

Other Audit Observations

The work that led to other audit observations was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Other Audit Observations

Main Points

17.1 The *Auditor General Act* requires the Auditor General to include in his Reports matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

17.2 The "Other Audit Observations" chapter fulfils a special role in the Reports. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments, or they report on audits and studies of issues that relate to operations of the government as a whole. This chapter reports on specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

17.3 The chapter normally contains observations concerning departmental expenditures and/or revenues. The issues addressed generally involve failure to comply with authorities, and the expenditure of money without due regard to economy.

17.4 Observations reported in this chapter cover the following:

- Space was leased at an excessive cost for a Canada Business Service Centre in Sydney, Nova Scotia that was never operated as intended;
- Inappropriate netting of benefit payments obscures the true size of government revenues and expenditures and complicates the evaluation of fiscal measures;
- Government programs and spending for Parc Downsview Park Inc. lack clear parliamentary authority;
- Non-recovery of expenditures for safe drinking water on Indian reserves affected by Manitoba Hydro development; and
- Significant risk that a $113 million relocation project will not adequately address the needs of the Innu.

17.5 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters we did not examine.

Introduction

17.6 This chapter contains matters of significance that are not included elsewhere in the Report and that we believe should be drawn to the attention of the House of Commons. The matters reported were noted during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

17.7 Section 7(2) of the *Auditor General Act* requires the Auditor General to call to the attention of the House of Commons any significant cases where he has observed that:

- accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

- essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue, and to ensure that expenditures have been made only as authorized;

- money has been expended other than for purposes for which it was appropriated by Parliament;

- money has been expended without due regard to economy or efficiency;

- satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or

- money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

This chapter contains a number of observations on matters of significance not included elsewhere in the Report.

17.8 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards; accordingly, our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department headings.

Atlantic Canada Opportunities Agency and Public Works and Government Services Canada

Space was leased at an excessive cost for a Canada Business Service Centre in Sydney, Nova Scotia that was never operated as intended

In September 1995, Public Works and Government Services Canada (PWGSC) on behalf of the Atlantic Canada Opportunities Agency (ACOA) entered into a lease for space at 338 Charlotte Street in Sydney that was to be used as a Canada Business Service Centre (CBSC). The amount of space leased, the fit-up costs, the rental rate per square metre, and the number of parking spaces acquired were all higher than those of the other Canada Business Service Centres in the Atlantic region. The occupancy costs for the CBSC in Sydney were 20 to 30 percent (or about $200,000) higher than for buildings of superior quality in downtown Sydney.

In October 1995, ACOA sublet all of the space to the Enterprise Cape Breton Corporation, the Province of Nova Scotia and non-government organizations. ACOA is still responsible for the lease and continues to pay for shortfalls in the rent collected.

In our opinion, PWGSC and ACOA did not ensure that the acquisition of space in Sydney represented value for money, and they did not conduct the process in a transparent manner.

Background

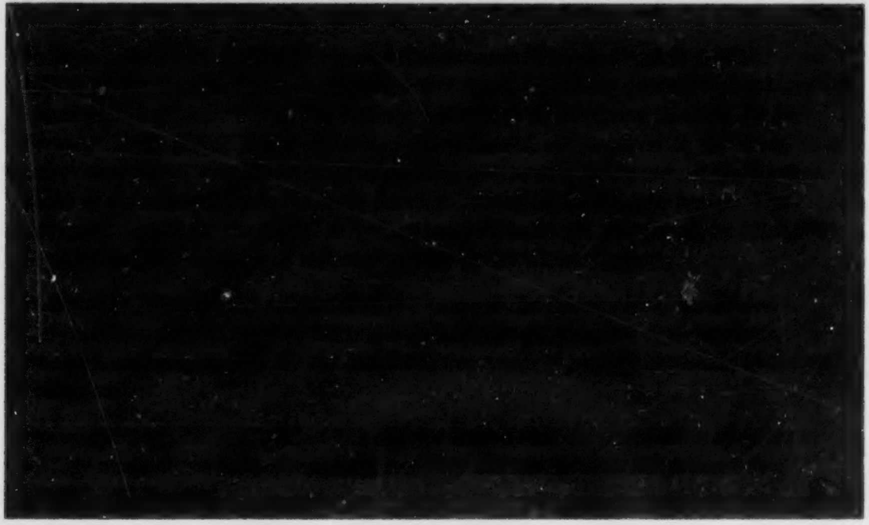
17.9 Canada Business Service Centres (CBSC) are a federal initiative, aimed at streamlining government services and improving access to them by businesses. They are one-stop storefront centres that house business services delivered by all three levels of government. Each service centre provides an electronic information centre and a walk-in counselling service. The 1994 Budget announced CBSCs as a government priority to establish a network of 10 hub centres across Canada — one in a major urban area of each province. In Atlantic Canada, ACOA led the initiative on behalf of the federal government. Initially, the government approved the establishment of four CBSCs in Atlantic Canada — at Fredericton, Charlottetown, Halifax and St. John's. ACOA developed and implemented a work plan that co-ordinated the launch and promotion of CBSCs in all four provinces.

17.10 On 10 November 1993, senior officials of ACOA and the Minister responsible for both ACOA and PWGSC discussed establishing a Canada Business Service Centre in Sydney. The Sydney Centre was to share a number of features with the other centres in the national network: common information resources; staff with a comparable classification; national service standards and evaluation requirements; and interconnectivity with other sites. ACOA would share the Centre with seven other federal government organizations as well as provincial and municipal partners.

17.11 In September 1995, PWGSC signed a six-year, $1.1 million lease on ACOA's behalf, with two additional one-year options. The lease was for space at 338 Charlotte Street in Sydney to house a Canada Business Service Centre. On 1 October 1995, ACOA sublet the entire space to the Enterprise Cape Breton

Atlantic Canada Opportunities Agency and Public Works and Government Services Canada

Space was leased at an excessive cost for a Canada Business Service Centre in Sydney, Nova Scotia that was never operated as intended



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Corporation, the Province of Nova Scotia and non-government organizations.

17.12 In April 1998, the Province of Nova Scotia entered into a 10-year lease with the property owner for part of the space it had sublet from ACOA. In September 2001 the Province will assume the lease for all of the rentable space in the building.

17.13 In his December 1999 Report, the Auditor General of Nova Scotia expressed concern about the lease arrangement signed by the Province in April 1998. He noted that the Province was paying 30 percent above market rate. It had bypassed the normal property management process to negotiate the lease and had made a future commitment to lease space for which it had no identified need. Because the Province had subleased this space from the federal government prior to signing its own lease, the Auditor General of Nova Scotia brought these concerns to our attention.

Issues

Unjustified space requirements

17.14 In March 1994, ACOA identified a need for 300 m^2 of office space for a Canada Business Service Centre in downtown Sydney. It asked PWGSC to obtain the space in a building at 338 Charlotte Street. This amount of space was comparable with that of other Canada Business Service Centres that ACOA had established in the Atlantic region. However, the call for tenders in June 1994 specified a need for 600 m^2. The tender call was amended one week later to increase the space requirement to 700 m^2 — the total rentable space in the three-storey building. The CBSCs in Halifax, Fredericton and St John's were already operating with 330 m^2, 392 m^2 and 300 m^2 respectively.

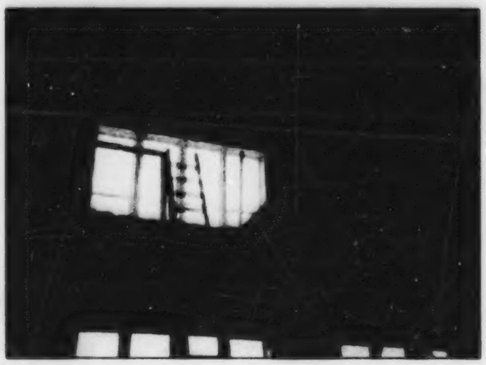
17.15 At ACOA's request, PWGSC included in the call for tenders a requirement for 50 parking places at the Sydney location. The other CBSCs established by ACOA have substantially fewer parking places — five in Fredericton, three in Charlottetown, eight in St. John's and none at the Centre in downtown Halifax. Eventually, ACOA accepted the landlord's offer to provide 25 parking places and later agreed to 12 on-site and 13 off-site parking places. Neither ACOA nor PWGSC could provide us with a reason why the Sydney CBSC required more parking than the four other CBSCs in the Atlantic region.

17.16 **Our concern.** The amount of office space and the number of parking places acquired for the Sydney location greatly exceeded those of other CBSCs in the Atlantic region.

The amount of office space and the number of parking places acquired for the Sydney location greatly exceeded those of other Canada Business Service Centres in the Atlantic Region.

Excessive costs

17.17 A market survey of the Sydney area that PWGSC had already conducted indicated that the building acquired for the CBSC had a rental rate, including client fit-up renovations, that was 20 to 30 percent higher than buildings of superior quality in downtown Sydney. The annual rental rate, excluding client fit-up renovations and business occupancy taxes, was $280 per square metre ($26.01 per square foot). PWGSC calculated that client fit-up and occupancy taxes added an additional $88 per square metre ($8.17 per square foot) to the annual cost of the lease.



Canada Business Service Centre at 338 Charlotte Street, Sydney, CBSC undergoing initial building renovations (see paragraph 17.17).

17.18 The client fit-up renovation costs of $190,000 for the Sydney location, although significantly lower than the $275,000 originally estimated by the landlord, were three to five times higher than the fit-up costs for other CBSC locations in the Atlantic region. The Auditor General of Nova Scotia noted that in 1998 the Province spent an additional $189,000 for the fit-up renovation of space in the same building.

17.19 **Our concern.** PWGSC determined prior to acquiring the space that the occupancy costs for this building significantly exceed the rates for other space of superior quality in the same area, by 20 to 30 percent (or roughly $200,000).

Use of the leased space

17.20 Having sublet the building space, ACOA is responsible for any shortfall between the rents it receives for the sublet space and the amount stipulated in its lease with the landlord. Thus, from September 1995 to March 2000, ACOA paid $116,903 in rent shortfalls for space it did not use.

17.21 The facility was never used for the purpose indicated in the documents justifying the acquisition of space — to operate a full-service Canada Business Service Centre. The CBSC was to be a shared arrangement with seven other federal government organizations as well as provincial and community partners. Seven of the eight federal government organizations that had initially been identified never occupied the premises. According to our information, at most only two federal employees were ever located at this site.

17.22 **Our concern.** Although ACOA has continued to pay a portion of the rent, the facility has never operated as a full-service CBSC.

Lack of openness, fairness and accountability

17.23 We found that throughout the leasing process neither PWGSC nor ACOA ensured that the process was conducted, and was seen to be conducted, openly and fairly.

17.24 In its original request, ACOA indicated to PWGSC that there was an urgent need to have the site suitable for occupancy within four months — by 1 June 1994. However, the lease was not signed until September 1995, 18 months after ACOA told PWGSC it needed the space. ACOA indicated orally to PWGSC that the Minister supported the location of the Business Service Centre on Charlotte Street. At least twice in March 1994, PWGSC wrote to ACOA requesting confirmation of ministerial support; ACOA neither confirmed nor refuted such support in writing.

17.25 PWGSC informed ACOA that its request for the Sydney location did not allow enough lead time for a public tender call. In order to proceed, approvals within PWGSC would be needed to exceed the standard office costs and renovations and to limit the geographic area eligible for public tenders. Furthermore, PWGSC said it expected that the rental rate would be above market rate.

17.26 Files for the four other CBSCs established by ACOA include reports indicating the buildings that were considered, a comparison of costs, other considerations, and recommendations for the selection, with supporting rationales. We could find no comparative analysis or rationale to support the rejection of other sites in Sydney.

17.27 In June 1994, a public notification of the call for tenders was posted by PWGSC and placed on the Open Bidding Service and the Government Business Opportunities bulletin boards. This call for tender initially specified a need for 600 m2 of space and an unusually high requirement of 50 on-site parking places. It also restricted the eligible location to a five-block section along a single street. The only bid received in response to the tender was deemed non-compliant since the bidder could not provide the on-site parking.

17.28 We reviewed documentation indicating that two other parties subsequently contacted PWGSC. One advised that it had not submitted a bid because it could not supply the required parking. The other indicated that it would be interested in bidding if the project were to be retendered. We found that after the initial call for tenders, no further public notifications followed, notwithstanding that in subsequent negotiations with the sole bidder the space requirements increased, the parking requirements were reduced, and the occupancy dates were changed.

17.29 In August 1994 the Deputy Minister's office advised the PWGSC Atlantic region that the Minister's office supported negotiating directly with the lone bidder, and officials should proceed with the negotiation immediately and report on their progress.

17.30 Throughout the leasing process, PWGSC challenged ACOA about the limits on the geographic area open to competition, the continuing changes to requirements, and the excessive rental and renovation rates. PWGSC indicated its concern that the process would not obtain the best value for the taxpayer or allow an opportunity for the public to participate in the tendering process. However, at no time did PWGSC halt the leasing or the renovation process.

17.31 Both PWGSC, as the central government leasing agent, and ACOA, as the client, had an obligation to ensure that the amount of space to be occupied was the minimum necessary for effective program delivery and represented the most economical use of government resources. The leasing process for the building in Sydney proceeded in the face of PWGSC's concerns about ACOA's request to negotiate a sole-source contract for the property at 338 Charlotte Street, its contention that an in-service date of 1 June 1994 was urgently needed, and the amount of space it said it required.

17.32 **Our concern.** In our view, this acquisition did not meet the objective of the Treasury Board Open and Fair Real Property Transactions Policy: "To ensure that real property transactions are, and are seen to be, conducted with openness and fairness." Consequently it was not carried out in a manner that would stand the test of public scrutiny in matters of prudence and probity.

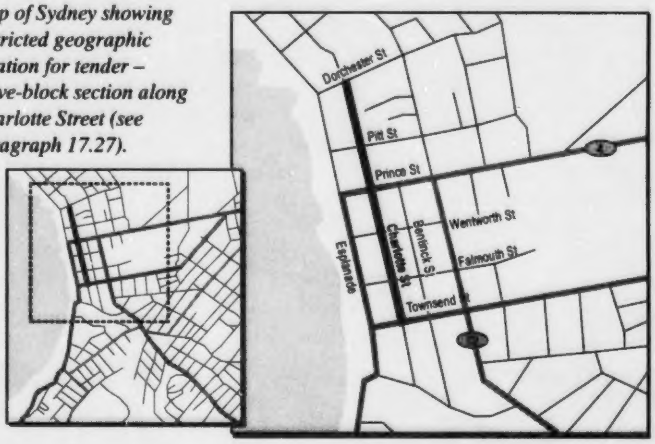
In our view, this acquisition did not meet the objective of the Treasury Board Open and Fair Real Property Transactions Policy.

Previous internal reviews

17.33 PWGSC and ACOA conducted internal reviews of this lease. The reviews were limited to preliminary surveys and did not identify issues for further audit.

17.34 In 1995 the Minister's Office asked PWGSC to review the events leading up to and including the acquisition of the leased accommodations. The focus of that review was not on value for money but on assessing the extent to which PWGSC had followed central agency and departmental policy and procedures in procuring space and had provided an appropriate response to the space requirement identified by ACOA.

Map of Sydney showing restricted geographic location for tender – a five-block section along Charlotte Street (see paragraph 17.27).



17.35 We reviewed the PWGSC audit files and the preliminary survey report from that review. It had concluded that:

- PWGSC had followed the government contracting regulations;
- the decision to proceed with negotiations with the sole bidder had been appropriate and consistent with government contracting practices;
- PWGSC had been mindful of the requirements to demonstrate prudence and probity in contracting;
- ministerial letterhead had been used inappropriately by a senior departmental employee assigned to the Minister's office to convey information in August 1994 that was the basis for proceeding with direct negotiation;
- no evidence was found of direction by the Minister or the Minister's staff; and
- there were no material issues that warranted further examination.

17.36 ACOA's internal audit division reviewed the documentation related to the Agency's involvement in the tendering and awarding of the contract for the lease of the Sydney space for a CBSC. The results of that review were incorporated into the PWGSC report. ACOA's internal audit review concluded that the Agency had acted prudently in providing information to PWGSC. The review found that in the tendering process, the determination of space requirements and the identification of the eligible area, the Agency's approach to the Sydney tender was consistent with its approach at other Atlantic Canada locations of Canada Business Service Centres it administers. ACOA has not supplied us with any working papers to support its conclusions.

17.37 **Our concern.** Our conclusions differ from some of those reported by PWGSC and ACOA.

Conclusion

17.38 In our opinion, the lease to acquire the space at 338 Charlotte Street does not represent value for money, because:

- the facility never operated as a full CBSC, although that was the original justification for the space requirements;
- the rental rate was higher than the market rate for space of superior quality;
- the stated requirements for space and parking exceeded requirements to operate a CBSC; and
- the urgency of the need for the space was not justified.

17.39 Space for the CBSC in Sydney was not acquired in a way that would meet the test of public scrutiny in matters of prudence and probity and ensure that "real property transactions are, and are seen to be, conducted with openness and fairness," because the process:

- focussed on one building from the beginning;
- continued despite the bidder's non-compliance with the requirements; and
- continued with frequent and significant changes to the requirements.

***Public Works and Government Services Canada's response:** Public Works and Government Services Canada is fully supportive of achieving value for money in the procurement process. However, the focus of the internal review was not value for money, and accordingly did not present a conclusion on the value-for-money issues addressed by the Auditor General.*

***Atlantic Canada Opportunities Agency's response:** The creation of the Canada Business Service Centres network was publicly announced as a federal government priority. However, it was a priority that often depended on the participation of many partners —up to 15 organizations had expressed an interest to participate in the Sydney undertaking. While the Agency is disappointed that many potential partners eventually decided not to offer their services from a shared location, the Agency was successful in signing substantial subleases that reflect changed circumstances and that limit the federal government's losses until its lease expires in less than a year.*

The Agency recognizes the need for all real estate transactions to be conducted in a manner that not only is, but may be seen to be, able to meet the tests of probity, prudence, openness and fairness.

Audit Team

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Government Financial Reporting

Inappropriate netting of benefit payments obscures the true size of government revenues and expenditures and complicates the evaluation of fiscal measures

The government's Budget and certain financial statements in the Public Accounts and the Annual Financial Report show revenues and expenditures net of payments for the GST credit and the Canada Child Tax Benefit. These payments constitute cash transfers to individuals and should be recorded as part of government spending. Offsetting them against revenues (in effect, treating them as tax reductions) results in confusing and misleading financial disclosure. Over time, this practice results in showing both tax revenues and program spending as much lower amounts than they really are. In the current year, the difference is approximately $9.5 billion.

Background

17.40 The GST credit and the Canada Child Tax Benefit (CCTB) are programs that provide cash payments to low- and middle-income Canadians. GST credit payments are made quarterly and CCTB payments monthly. They are delivered through the tax system: the Canada Customs and Revenue Agency determines eligibility and sends out payments based on returns filed by beneficiaries. Amounts paid are based on family composition and income.

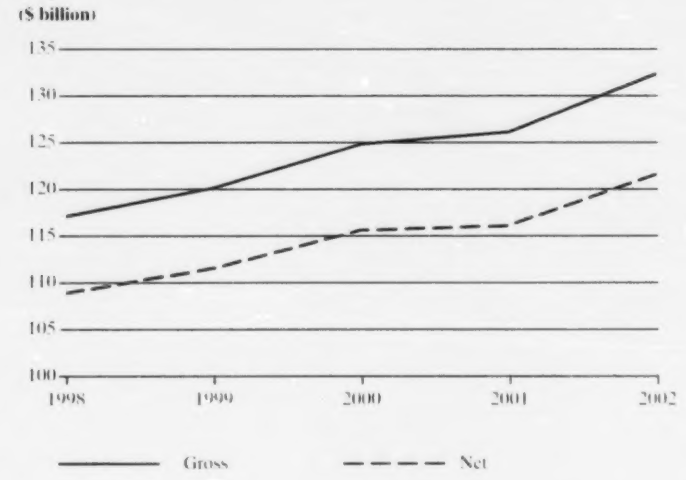
17.41 Budget documents and some financial statements in the Public Accounts and the Annual Financial Report show these payments as reductions in taxes. As a result, at times the government's financial statements show aggregate spending and tax revenues lower by the amount of these payments (see Exhibit 17.1).

17.42 The amounts involved are significant and growing. In 1990-91, Child Tax Credit payments amounted to $2.1 billion. This year, payments under CCTB (the successor to the Child Tax Credit and family allowances) are estimated at some $6.5 billion and by 2004 are projected to exceed $9 billion. Sales tax credits have grown from $700 million 10 years ago to roughly $3.0 billion today.

17.43 For a number of years, this Office has expressed concern about the government's practice of netting GST credit payments and CCTB payments against revenues. While the practice has no impact on the government deficit or surplus (since both revenues *and* expenditures are reduced by the same amount), it results in confusing and even

Exhibit 17.1

Program Spending — Net and Gross of GST Credit and CCTB



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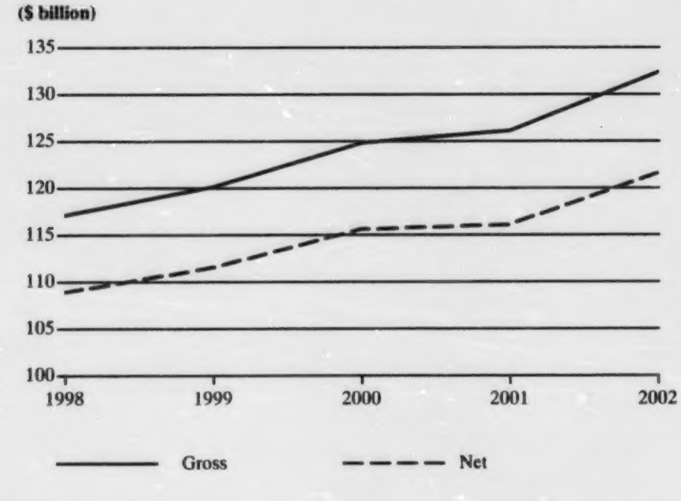

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17.43 For a number of years, this Office has expressed concern about the government's practice of netting GST credit payments and CCTB payments against revenues. While the practice has no impact on the government deficit or surplus (since both revenues *and* expenditures are reduced by the same amount), it results in confusing and even misleading financial information. The problem has become more serious over the years, as reliance on the tax system to deliver social transfers has increased.

Issues

17.44 Financial statements that reflect the government's financial situation clearly and fairly are essential to an informed citizenry and to democratic accountability. The netting of GST credit payments and CCTB payments against revenues obscures the true size of government and complicates the scrutiny and evaluation of the government's performance.

17.45 In the government's view, treating GST credits and CCTB payments as tax reductions is appropriate because, as argued in *The Budget Plan 2000*, they "are integral parts of the tax system. These programs are administered through the tax system. They are thus netted from tax revenues for budgetary purposes".

17.46 The government is saying, in effect, that the medium is the message. But why should the method of delivery trump substance in classifying a program? Transfers made under the GST credit and CCTB programs differ little from other transfer payments: they provide cash benefits to individuals and households that satisfy certain criteria for eligibility. Administering them through the tax system does not convert these transfers into tax reductions. Recipients qualify on the basis of income and demographic characteristics. That is the same basis, for example, on which OAS/GIS benefits are also delivered. Should we offset those payments against taxes as well?

17.47 Objective accounting principles place GST credit payments and CCTB payments squarely on the expenditure side of the government's ledger. As specified in the International Monetary Fund's *A Manual on Government Finance Statistics*, any payments to taxpayers (other than reimbursements for incorrect collections), "whether referred to as tax refunds, tax credits, or by any other term, are classified as government expenditure". Similarly, in the Canadian System of National Accounts (patterned closely after the international standard described in the UN publication *System of National Accounts*), Statistics Canada treats both GST credit payments and CCTB payments as government spending and reports government revenues and expenditures gross of these amounts. This treatment conforms to principles enunciated by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants, which require that revenues and expenditures be disclosed on a gross basis.

17.48 Some presentations in the government's Annual Financial Report and in the Public Accounts show revenues and expenditures both gross and net of GST credit payments and CCTB payments. This creates confusion — needlessly, since, as argued here, netting these payments against revenues is inappropriate.

Transfers made under the GST credit and Canada Child Tax Benefit programs differ little from other transfer payments.

17.49 For the most part, budget documents report revenues and expenditures on a net basis only. An annex to *The Budget Plan 2000*, tabled by the Minister of Finance with his Budget last February, shows the CCTB and several other tax credits as both tax reductions and expenditure increases. However, in the rest of that document, and in other budget papers as well, the GST credit and CCTB payments are treated as tax reductions only and are netted against revenues. In our opinion, this results in misleading financial disclosure. To illustrate: Appropriately accounted for, projected reductions in personal income taxes under the February 2000 Budget's five-year tax-reduction plan would be shown as $32.5 billion, not $39.5 billion as reported in the Budget (since roughly $7 billion of the reported "tax reductions" consist of CCTB payment increases); the ratio of spending increases to tax decreases (over the period 2000-03) from initiatives announced in that Budget would be close to 50:50, not 40:60 as budget figures imply; and program spending this year as a proportion of GDP would be shown at 12.6 percent, not 11.6 percent.

Conclusion

17.50 Payments made under the GST credit and CCTB programs constitute government spending, similar to that of other income-tested transfer payments to individuals. For reasons of efficiency and effectiveness, they are delivered through the tax system. They are not thereby transformed into tax reductions: they remain expenditure items. Consistent with that fact and in compliance with objective accounting principles, they should be reported in the government's books as government expenditures. The practice of treating them as tax reductions and netting them against revenues results in confusing and misleading financial disclosure, and should be discontinued.

Department of Finance's response: *There are strong policy arguments in favour of netting the CCTB and GST credit, as explained below. And, as the Auditor General's observation states, the accounting practice has "no impact on the government's deficit or surplus." Furthermore, information on both a gross and net basis is presented in the Annual Financial Report and the Public Accounts of Canada, and the 2000 Budget presented the impact of the tax expenditure initiatives both as a tax reduction and a spending initiative. Given that information is presented both on a gross and a net basis, it is therefore difficult to see how the presentation in the financial statements can be "misleading."*

The issues involved are much more complex than those indicated in the Report. For example, is it the mechanism used to deliver a benefit or the intent that should determine the classification? This is especially applicable with respect to the low-income GST credit, which was introduced at the same time as the GST was implemented. The low-income GST credit replaced the federal sales tax (FST) refundable credit, which was introduced in the mid-1980s when the FST rate was increased and its base expanded. The intent was to compensate lower-income Canadians for the incremental price effect of replacing the manufacturer's sales tax with the GST. One way this could have been done would be to assign special cards to these Canadians, giving them a lower rate at the time of purchase and thereby reducing revenues in the same way as netting. This is in fact what is being done for new house purchases where the rate is about 4.5 percent rather than 7 percent and the rebate is netted against GST revenues. Another option would be to have these people remit receipts of amounts of GST paid and provide applicable rebate. This is what is done for foreign visitors, which again is netted against GST revenues. It is also what is done for municipalities and not-for-profit organizations. However, from an administrative perspective, these options to deliver a lower rate or rebate to low-income Canadians would be extremely difficult and costly to administer and open to abuse. So instead, the lower rate or rebate is being delivered through a refundable tax credit, which is netted against GST revenues, in the same manner as the other lower rates and rebates. This was done out of administrative convenience but the intent is clear. There are similar issues with respect to the Canada Child Tax Benefit, which is provided to a significant number of Canadians who do pay income tax.

The audit observation deals only with the CCTB and GST credit, implying that these are the only items involved. However, there are also issues surrounding the recording of revenues from consolidated Crown corporations, revenues received by departments/agencies for services provided and revenues earned from past *and previous borrowings. The issues involved are different from those concerning the CCTB and GST credit, which are not addressed in the observation.*

The Report implies that the government is misleading Canadians on the impact of its Five-Year Tax Reduction Plan. However, this is not an issue about accounting. The government has been very clear on what is included in the Plan and what is not, irrespective of the accounting conventions used. It is about what impacts average Canadians, whether they pay taxes or not.

Audit Team

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Parc Downsview Park Incorporated

Parliamentary control of programs and spending

Our recent annual Auditor's Reports on the financial statements of Canada Lands Company Limited and its subsidiary, Parc Downsview Park Incorporated, refer to the fact that the Government of Canada has not requested — and accordingly, to date, Parliament has not provided — clear and explicit authority for the creation and operation of an urban park, nor has Parliament authorized the related spending of public funds.

In our view, if the Government of Canada wishes to set up an urban park and invest more than $100 million of public funds therein, it should have clear and explicit approval from Parliament to do so.

Background

17.51 In its 1994 Budget, the government announced the closure of Canadian Forces Base Toronto at Downsview. The National Defence Budget Impact Paper, referred to in the Budget, went on to say "[the] Downsview site will be held in perpetuity and in trust primarily as a unique urban recreational green space for the enjoyment of future generations."

Downsview Park was incorporated in July 1998 and began operations in April 1999.

17.52 In November 1995, the government approved the following principles for development of the park:

- Retain more than one-half of the site as parkland.
- Be "self-financing" from sources outside federal appropriations (with some limited exceptions) including the ability to raise limited debt from the private sector.
- Be capable of raising and retaining other qualifying revenues, and forming corporate relationships with third parties for this purpose.
- Operate on the principle of a "trust concept" recognizing the special nature of these lands.
- Accommodate a continuing military presence.

17.53 In April 1997, the government issued an order-in-council authorizing Canada Lands Company Limited to set up a subsidiary corporation to develop the park.

17.54 Canada Lands Company Limited, originally named Public Works Lands Company Limited, was incorporated under the *Companies Act* in 1956. Its charter, continued under the *Canada Business Corporations Act*, specifies the following purposes and objects: to acquire, purchase, lease, hold, improve, manage, exchange, sell, turn to account or otherwise deal in or dispose of real or personal property or any interest therein. Canada Lands Company Limited (Canada Lands) was listed as a parent Crown corporation in 1984 in Part I of Schedule III of the *Financial Administration Act (FAA)*.

17.55 Canada Lands incorporated Parc Downsview Park Inc. (Downsview Park) as a wholly owned subsidiary Crown corporation in July 1998, and Downsview Park began operations in April 1999.

Issues

17.56 In order to implement its intentions for Downsview Park, the government has:

- issued an order-in-council authorizing Canada Lands to incorporate a new Crown corporation, Parc Downsview Park Inc., as a subsidiary of Canada Lands

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Issues

17.56 In order to implement its intentions for Downsview Park, the government has:

- issued an order-in-council authorizing Canada Lands to incorporate a new Crown corporation, Parc Downsview Park Inc., as a subsidiary of Canada Lands pursuant to paragraph 91(1)(a) of the *Financial Administration Act*;

- transferred control and responsibility, as well as the benefits from management of the Downsview lands, to Canada Lands and subsequently to Downsview Park under a management agreement with National Defence, while National Defence continues to hold title to the lands;
- provided initial funding of Downsview Park from an existing National Defence vote; and
- issued an order-in-council authorizing the transfer of the first parcel of land (about 32 acres) to Downsview Park pursuant to paragraph 16(1)(a) of the *Federal Real Property Act*.

17.57 Also, in contrast to the normal practice when the government transfers properties to Canada Lands, the proceeds from the development and operation of properties transferred to Downsview Park will not be deposited in the Consolidated Revenue Fund; rather, they will be spent on the development and operation of the park.

17.58 Parliamentary authority was not sought for any of the above-noted activities.

No parliamentary approval to develop the Downsview Park

17.59 Downsview Park, a unique, urban recreational green space owned and operated by the Government of Canada, represents a significant departure from national parks. Rather than a wilderness that needs to be protected, Downsview Park is an urban site that is being transformed into a park.

17.60 Despite some similarities, there are significant differences in mandates and operating characteristics between Canada Lands, the parent corporation (commercial property disposal) and its subsidiary (non-commercial park management).

17.61 Normally, when a new Crown corporation is established with unique operating characteristics, it receives a mandate from Parliament through legislation establishing a parent Crown corporation. In this case, the government chose to set up Downsview Park as a subsidiary. It required only an order-in-council to accomplish its purpose.

No parliamentary approval to spend funds on the Park

The government chose to set up Downsview Park through an order-in-council.

17.62 In August 1998, the government confirmed its intentions for Downsview Park:

- Land intended for residential and commercial development would be transferred to Downsview Park and the net proceeds of the subsequent development would accrue to the Park.
- Leasing revenues generated by interim management of the site would accrue to Downsview Park.

17.63 Downsview Park was capitalized by $2.9 million of surplus funds generated by property management activities at the Downsview Park base up to 31 March 1999. Leasing revenues for the next four years are expected to exceed $20 million.

Proceeds from the development of Downsview Park will not be deposited in the Consolidated Revenue Fund.

17.64 Half the land (300 acres) will be used for commercial or residential development. The other 300 acres will be developed as a park. Downsview Park expects that commercial and residential development will generate more than $145 million over the next 15 years for developing and operating the park.

17.65 In August 1999, the Treasury Board approved the first transfer of land for commercial development and acknowledged that Downsview Park would not be in a position to pay anything for the land for "decades."

17.66 Normally, the government acquires land to meet its needs to deliver a program, such as National Defence. When the land is no longer needed for program purposes, it is declared surplus and is sold. The proceeds from the sale are returned to the Consolidated Revenue Fund (CRF). Parliament then votes on its program priorities and appropriates money from the CRF through the Estimates process. This process is intended to ensure that spending of public money is authorized by Parliament.

17.67 In the case of Downsview Park, the government has, in substance, transferred assets to another entity and, by developing those assets, intends to fund new program activities. Parliament was not asked to appropriate funds for development of the park and for park activities.

The government needs to get clear and explicit approval from Parliament for Downsview Park.

Other problems due to the mechanisms used to create Downsview Park

17.68 The government's choice of the subsidiary corporation legal form has led to difficulties in achieving its vision of the Downsview Park and to a number of other difficulties.

17.69 During 1999-2000, National Defence spent approximately $4.8 million for Downsview Park operations and development. It expects to spend $4.5 million annually on Downsview Park for the next three years. To date, these expenditures have been charged to National Defence's Vote 1, which Parliament has authorized to be used for the Department's operating expenditures. In our view, the expenditures related to the development of the Downsview Park site (approximately $2 million of the $4.8 million) are not a valid charge against National Defence Vote 1.

17.70 Downsview Park, like its parent, is a taxable Crown corporation. The "trust" concept for the new park contemplated that Downsview Park would be eligible to receive charitable donations. Canada Lands was authorized to incorporate Downsview Park Foundation to solicit charitable donations in support of the park. However, under the *Income Tax Act*, the Foundation may donate its funds only to a "qualified donee". Downsview Park is not a "qualified donee" for income tax purposes. Canada Lands has recognized this problem and has proposed setting up an additional charitable organization to receive donations collected by the Downsview Park Foundation.

17.71 Downsview Park's taxable status introduces complexities to the acquisition of property. If property is acquired at no cost, it results in higher income taxes when the property is sold and it can also result in capital taxes. This has added to the delay in transferring properties, as taxes would absorb funds meant for the park.

Conclusion

17.72 Each step in the founding and development of Downsview Park was completed in accordance with the relevant governing legislation — except for the payment of $2 million, as described in paragraph 17.69. However, the individual steps together had the effect of leaving Parliament out of the decision-making process.

17.73 In our view, if the Government of Canada wishes to set up an urban park and invest more than $100 million of public funds therein, it should have clear and explicit approval from Parliament to do so.

Public Works and Government Services Canada's response: *Following approval of the Downsview Park initiative as part of the 1994 Budget, the establishment of the urban park and the subsidiary corporation to manage the park's development, Parc Downsview Park Inc., has been undertaken in a manner that respected both the role and the authority of Parliament, as expressed through the legislative framework governing Crown corporations.*

Although the Auditor General acknowledges that each step in the founding and development of Downsview Park was completed in accordance with the relevant governing legislation, the Auditor General has expressed the opinion that clear and explicit parliamentary authority should have been sought for the project. The mandate and purposes of Parc Downsview Park Inc. are fully consistent with those of the parent corporation, Canada Lands Company Limited, and the other current and past subsidiary corporations of the parent, for example, the CN Tower and the Old Port of Montreal.

It is further noted that the development of Downsview Park has been conducted in an open and transparent manner, with ongoing opportunities for consultation and review by Parliament through the annual tabling of legislated reports.

Audit Team

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Principal: Crystal Pace

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Indian and Northern Affairs Canada

Non-recovery of expenditures for safe drinking water on Indian reserves affected by Manitoba Hydro development

In the 1970s, five Indian reserves that were home to over 7,500 Cree Indians were adversely affected as a result of hydro-electric development by the Manitoba Hydro-Electric Board (Manitoba Hydro).

Under a 1977 agreement to compensate the communities for the effects of the hydro-electric development, Indian and Northern Affairs Canada undertook to ensure the continuous availability of potable water to the residents of the five reserves. Manitoba Hydro undertook to reimburse the Department for 50 percent of the expenditures it incurred for this purpose, to the extent that those expenditures were attributable to the adverse effects of the hydro projects.

The development began over two decades ago, and by June 2000 the Department's water, sewer and related expenditures for the five affected First Nations had reached about $151 million. However, the Department has not recovered any portion of these expenditures from Manitoba Hydro.

Background

17.74 In December 1977, the Northern Flood Agreement (NFA) was entered into by four parties to provide a framework for compensating five Indian communities, home to over 7,500 Cree Indians, for the adverse effects of hydro-electric development projects by Manitoba Hydro, a provincial Crown corporation. The development projects involved the diversion of the Churchill River into the Nelson River so that generating stations along the Nelson could produce more hydro-electric power. By 1977, Manitoba Hydro had diverted up to 90 percent of the Churchill River into the Nelson River.

17.75 The four parties to the agreement were the Government of Manitoba (Department of Northern Affairs), the Manitoba Hydro-Electric Board (Manitoba Hydro), the Northern Flood Committee Inc. (an Indian corporation representing the five affected communities) and the Government of Canada (Indian and Northern Affairs Canada).

17.76 Under the 1977 NFA, Indian and Northern Affairs Canada undertook to ensure the continuous availability of safe drinking water to the five affected communities. Under the same agreement, Manitoba Hydro undertook to reimburse the Department for 50 percent of the expenditures incurred in providing such water, to the extent that the Department's expenditures were attributable to the adverse effects of Hydro projects.

17.77 The agreement provides for the arbitration of disputes that cannot be settled directly by the parties. It further provides for the removal of the arbitrator upon agreement of three of the four parties.

17.78 Claims were filed with the arbitrator by the affected communities in 1982 and by the Department in 1984. The disputes centred on the communities' allegations that the Department was not meeting its obligation to ensure a continuous supply of potable water, as well as the Department's allegations that Manitoba Hydro was failing to pay its share as required under the agreement. Multi-party negotiations to settle these claims, including direct negotiations

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Non-recovery of expenditures for safe drinking water on Indian reserves affected by Manitoba Hydro development

In the 1970s, five Indian reserves that were home to over 7,500 Cree Indians were adversely affected as a result of hydro-electric development by the Manitoba Hydro-Electric Board (Manitoba Hydro).

Under a 1977 agreement to compensate the communities for the effects of the hydro-electric development, Indian and Northern Affairs Canada undertook to ensure the continuous availability of potable water to the residents of the five reserves. Manitoba Hydro undertook to reimburse the Department for 50 percent of the expenditures it incurred for this purpose, to the extent that those expenditures were attributable to the adverse effects of the hydro projects.

The development began over two decades ago, and by June 2000 the Department's water, sewer and related expenditures for the five affected First Nations had reached about $151 million. However, the Department has not recovered any portion of these expenditures from Manitoba Hydro.

Background

17.74 In December 1977, the Northern Flood Agreement (NFA) was entered into by four parties to provide a framework for compensating five Indian communities, home to over 7,500 Cree Indians, for the adverse effects of hydro-electric development projects by Manitoba Hydro, a provincial Crown corporation. The development projects involved the diversion of the Churchill River into the Nelson River so that generating stations along the Nelson could produce more hydro-electric power. By 1977, Manitoba Hydro had diverted up to 90 percent of the Churchill River into the Nelson River.

17.75 The four parties to the agreement were the Government of Manitoba (Department of Northern Affairs), the Manitoba Hydro-Electric Board (Manitoba Hydro), the Northern Flood Committee Inc. (an Indian corporation representing the five affected communities) and the Government of Canada (Indian and Northern Affairs Canada).

17.76 Under the 1977 NFA, Indian and Northern Affairs Canada undertook to ensure the continuous availability of safe drinking water to the five affected communities. Under the same agreement, Manitoba Hydro undertook to reimburse the Department for 50 percent of the expenditures incurred in providing such water, to the extent that the Department's expenditures were attributable to the adverse effects of Hydro projects.

17.77 The agreement provides for the arbitration of disputes that cannot be settled directly by the parties. It further provides for the removal of the arbitrator upon agreement of three of the four parties.

17.78 Claims were filed with the arbitrator by the affected communities in 1982 and by the Department in 1984. The disputes centred on the communities' allegations that the Department was not meeting its obligation to ensure a continuous supply of potable water, as well as the Department's allegations that Manitoba Hydro was failing to pay its share as required under the agreement. Multi-party negotiations to settle these claims, including direct negotiations between the communities and Manitoba Hydro, continued at various times during this period through to 1988 and beyond. However, no monetary resolution was reached.

17.79 In May 1988, the Department, without the participation of Manitoba Hydro, entered into an agreement with the five communities and other parties to satisfy its obligation for potable water. Under this agreement, the Department was to provide $88.5 million to a contractor, authorized by the affected communities; the contractor was to implement a major water system development project to service 90 percent of the homes. The Department agreed to transfer any expenditures it recovered from Manitoba Hydro to the contractor to expand the scope of the water system development, although specific projects to be funded by the recoveries were not identified. According to the Department, the project was substantially completed by March 1992.

17.80 At July 2000, Manitoba Hydro, in consultation with the Department and the affected First Nations, was in the preliminary stages of planning additional hydro-electric development projects.

17.81 In 1992 (Chapter 15) and 1994 (Chapter 2), we reported our audit findings on selected issues concerning Indian and Northern Affairs' implementation of the Northern Flood Agreement.

Scope

17.82 This audit assesses the Department's application of the expenditure recovery provisions in the December 1977 Northern Flood Agreement and the related May 1988 agreement respecting its obligation to ensure a continuous supply of potable water to the communities.

17.83 We did not attempt to establish the amount that was spent to provide potable water and how much, if any, should be recoverable. That responsibility belongs to Indian and Northern Affairs Canada. Although there are necessary references to other parties, our observations are directed to the Department as the Crown's custodian of the reserve lands.

Issues

A lingering dispute

17.84 In our 1992 audit, we observed that a major dispute had developed regarding the determination and recovery of Indian and Northern Affairs Canada expenditures from Manitoba Hydro. The expenditures pertained to the Department's obligation under the Northern Flood Agreement to ensure a continuous supply of safe drinking water. The Department considered that Manitoba Hydro owed up to $80 million, as of 1988, for its share of the new water system and related operating costs. Manitoba Hydro disagreed and made no reimbursement to the Department.

The issue of non-recovery of expenditures has lingered for over 20 years.

17.85 In our current review of this case, Indian and Northern Affairs Canada reported that it had provided $151 million for capital and operating costs for water-related projects in the five communities between 1976 and June 2000. These expenditures include $65 million for costs of water systems and related items incurred under the 1988 agreement.

17.86 The Department indicated that Manitoba Hydro and the Department remain far apart on what portion of the expenditures should be recoverable from Manitoba Hydro. At July 2000, more than two decades since the hydro-electric development, no settlement had been reached. The Department has not recovered any expenditures under the 1977 Northern Flood Agreement, and consequently no additional funds have been transferred to the communities' contractor as provided for under the 1988 agreement.

Why the Department has not recovered Manitoba Hydro's share of expenditures

17.87 Several factors have contributed to the Department's lack of recovery. The following are some of them, based on departmental information.

About $151 million has been spent on water-related projects.

17.88 Deficiencies in the Northern Flood Agreement. The Department signed an ambiguous agreement, thereby contributing to the dispute. For example, the NFA provides for Manitoba Hydro to reimburse Indian and Northern Affairs Canada for the adverse effects of the hydro-electric projects, but does not indicate what would constitute adverse effects, how they would be identified and evaluated, or how they would be attributable to Hydro's projects.

17.89 The NFA fails to set out an agreed-upon course of remedial action respecting the adverse effects and the supply of potable water. In addition, the agreement does not indicate the criteria and methodology to be used for calculating costs of significant obligations and deadlines for performance and payment.

17.90 The deficiencies in the NFA have given the individual parties the opportunity to interpret the agreement to their respective advantages, thereby prolonging an old dispute.

17.91 Lack of linkage of development impacts to remedial action and costs. It is not evident that baseline information on water conditions, necessary for determining the impacts of the hydro projects, was gathered and assessed before the projects began. Consequently, it has become arguable whether the remedial action and associated expenditures are consistent with the parties' intent when the Northern Flood Agreement was signed in 1977.

17.92 In addition, no agreement was obtained among the parties as to what would constitute recoverable costs as a result of the hydro development. Currently, studies and the completion of a database on water flows and water quality are in progress, with the involvement of the Department. It is expected that these will help to determine the impact of the hydro-electric projects on potable water.

17.93 Lack of finalization of the Department's claim. In June 2000, Indian and Northern Affairs Canada updated its analysis of expenditures for water-related projects. This analysis, totalling approximately $151 million, is still under review.

17.94 We noted that the NFA imposes a "reverse onus" requirement on Manitoba Hydro; that is, Hydro must establish that its projects did not cause or contribute to an adverse effect where any claim arises by virtue of an actual or purported adverse effect of the projects. Since the Department routinely funds various types of capital projects on reserves, a major unresolved issue is the extent to which its expenditures for potable water are attributable to the adverse effects of the hydro-electric projects.

17.95 Use of arbitration. The Northern Flood Agreement provides that disputes may be settled by arbitration. In 1984, the Department filed a claim with an arbitrator for the recovery of expenditures incurred for potable water. This claim, however, did not specify the amounts to be recovered from Manitoba Hydro. Although some arbitration decisions have been made over the years, the arbitrator has made no monetary quantification of this claim. In addition, the Department suspended active pursuit of the claim when it chose to negotiate broader NFA implementation agreements with the affected First Nations.

17.96 In our view, the Department has a responsibility to assess the progress of arbitration; this includes the reasons for delays caused by any party, including itself. The Department and other parties could have applied at any time during the past 16 years to the appropriate courts for relief from undue delays if an assessment of progress indicated that this was warranted.

Current status of the Department's claim

17.97 According to the Department, its intention in recent years was to recommence a formal hearing process on the claim in 1998. The planned hearing date was deferred to the fall of 1999 and again in 2000 to spring 2001. Reasons cited for the lengthy process include the complexity of the case and the information needs that must still be met.

17.98 In addition, the Department is currently developing a negotiating protocol that it believes may lead to further discussions with Manitoba Hydro.

Conclusion

17.99 We are concerned that for over 20 years, Indian and Northern Affairs Canada has not made any recoveries from Manitoba Hydro pursuant to the Northern Flood Agreement. The potential amount is substantial.

17.100 We believe that the Department has taken an unreasonably long time to finalize the information necessary to complete and support its claim for reimbursement. We urge the Department to use its experience in this case to avoid similar problems in future hydro-electric projects that are currently being planned.

Indian and Northern Affairs Canada's response: *Indian and Northern Affairs Canada acknowledges the observations made in regard to challenges in implementing the Northern Flood Agreement (NFA) and in particular to the recovery of a portion of departmental expenditures from Manitoba Hydro for the provision of a safe supply of water to the five affected NFA communities. Accordingly, the Department is further intensifying its efforts to effect recoveries from Manitoba Hydro.*

The Department, in consultation with the five NFA communities, continues to refine its strategy to deal with the outstanding issues arising from the recovery provisions of the NFA. The need to be clear on obligations and how roles and responsibilities of the parties will be discharged continues to be a critical factor in the development of this strategy. The Department notes the point made in regard to avoiding problems associated with a lack of clarity when entering into similar agreements in the future.

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Indian and Northern Affairs Canada

Significant risk that a $113 million relocation project will not adequately address the needs of the Innu

For many years, the island community of 600 Mushuau Innu of Davis Inlet in Labrador has experienced substandard living conditions, poor health, suicides, substance abuse and the erosion of the traditional way of life, with little indication or hope of a remedy.

In 1994, the federal government responded to the situation with commitments to relocate the Innu residents to the mainland, as they desired. In so doing, the Department agreed in 1996 to provide $82 million for a major infrastructure development project in the new location. The relocation, together with other intended measures involving the Department, was seen as a remedy to the long-standing social pathologies.

We found that success has been jeopardized because, among other things, there is little evidence that the Department fully identified, adequately planned and effectively implemented the necessary measures to remedy the social pathologies. Consequently, there is a significant risk that the causes of these conditions will not be adequately addressed through the relocation. In this event, suffering will continue and substantial sums will have been spent without achieving intended results.

In addition, the infrastructure development project is at least one year behind its five-year schedule and the estimated total costs to completion have increased to $113 million, or about 35 percent above the initial authorization.

Background

The problem

17.101 The plight of the residents of Davis Inlet has surfaced periodically over many years. Reports of suicides and attempted suicides, severe unemployment, substandard living conditions, substance abuse, poor health and fatal fires have painted a dismal picture of life in the community. Their state of affairs brought the community to national and international attention, and the issue of responsibility was raised. In July 1992, the community brought a complaint to the Canadian Human Rights Commission against the Government of Canada and the Government of Newfoundland and Labrador.

17.102 The complaint alleged that Canada had failed to exercise its constitutional responsibility in respect of the Innu, with a consequential failure to provide the Innu with the level and quality of services received by other Aboriginal peoples in Canada. The complaint also asserted that the Mushuau Innu had been subjected to two relocations since 1947, with the knowledge or involvement of Canada and of Newfoundland and Labrador. These moves had contributed to a high level of social dysfunction caused by inadequate housing and impediments against traditional hunting pursuits. As well, there were several indications that the health of the Innu residents of Davis Inlet was cause for serious concern.

17.103 The Innu also claimed unquantified compensation from Canada for its alleged failure since 1949, when

Indian and Northern Affairs Canada

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Newfoundland joined Canada, to recognize the constitutional status of the Innu, and for the government's alleged breach of its fiduciary duty to them. Among other allegations, the Innu expressed their belief that the government had discriminated against them and had infringed on their rights.

17.104 In November 1992, the Canadian Human Rights Commission engaged an independent investigator to examine the grievances of the Innu and to recommend corrective measures where warranted. The resulting report in August 1993 generally supported the Innu. However, in the opinion of the Commission, the case did not fall within its jurisdiction and therefore it never formally decided the Innu claim.

The remedy

17.105 By February 1994, the Government of Canada recognized the Mushuau Innu as being Indians within the meaning of the *Constitution Act, 1867*. In doing so, the Department announced its support for the relocation of the Innu, as desired by them, from the Davis Inlet site. The intention was that the relocation would contribute to an effective remedy to the residents' unsatisfactory socio-economic situation by assisting in the longer-term renewal of the health, culture, society and economy of the Mushuau Innu people.

17.106 The Innu voted on five possible relocation areas. Their overwhelming choice was to adopt Little Sango Pond, Natuashish, located on the mainland of Labrador, some 15 kilometres away from their current island site at Davis Inlet. According to departmental information, the Innu believed that this site would provide sufficient fresh water and meet other essential needs of the community.

17.107 Canada (Indian and Northern Affairs Canada), Newfoundland and Labrador and the Mushuau Innu Band Council signed the Mushuau Innu Relocation Agreement (MIRA) in November 1996. Under the MIRA, the Government of Newfoundland and Labrador provided the land for the new community site by means of a lease with the Innu for 20 years at a cost of $1. The lease provides for its renewal or possible transfer of land title to the Innu.

The Department is providing substantial funding for the relocation of the Innu.

17.108 Indian and Northern Affairs provided funding for relocation planning, design, construction and other related items at an estimated cost of $82 million in 1996, later increased to $113 million. The cost elements include water and sewer systems, roads, power station, school, nursing station, airport, wharf, post office, housing, offices, police and fire facilities and other infrastructure items, as well as decommissioning of the existing site. Payments pursuant to the MIRA are made under annual contribution arrangements between the Department and the Mushuau Innu Band Council. At March 1999, $47 million had been spent toward the relocation.

Scope

17.109 The history of the Mushuau Innu records at least two previous relocations prior to the current one in progress. They have occupied their current site at Davis Inlet since 1967.

17.110 Given the current state of affairs, it is evident that any relocation can pose a great risk to the well being of the community. It therefore becomes especially important that relocation initiatives include careful consideration by the Department of all the elements required to successfully address the known social pathologies.

17.111 Our review focussed on whether the Department had taken adequate steps to ensure that the relocation would achieve the intended results.

Issues

Addressing social pathologies

17.112 The objectives of the MIRA are to provide for the relocation of the Mushuau Innu from Davis Inlet for the purpose of assisting in the longer-term renewal of their health, culture, society and economy. The Department's main responsibilities were to ensure that the relocation was properly managed, while also ensuring that the socio-economic needs of the community in their chosen location would be effectively addressed.

The relocation agreement seeks to help improve the Innu way of life.

17.113 Accordingly, we expected the Department, as project leader, together with the Mushuau Innu, to have fully identified, planned and implemented the measures needed to remedy the social pathologies. In this regard, the Department possessed several socio-economic studies submitted by the Innu between 1992 and 1995.

17.114 In December 1995, the Innu reported their social reconstruction plan to the Department to meet a condition of the Department's 1994 commitment to address their needs.

The Department does not have a plan to address the specific socio-economic needs.

17.115 The social reconstruction plan identified many socio-economic needs and listed 131 intended initiatives as solutions. These included projects on Innu culture, health and social services, education and training, justice, and traditional and non-traditional economies. The plan also referred to numerous other reports on social and technical matters that the Innu had provided previously to the Department.

17.116 However, we found little evidence that the Department had adequately assessed the December 1995 Innu social reconstruction plan to determine its potential contribution to an effective remedy. Nor did the Department have an overall action plan to specifically address the reported issues, despite its requirement that the Innu conduct and report such studies to it. The Department indicated in August 2000 that a plan for remediating the health and social ills will be developed in concert with other federal and provincial departments. The delay in developing a plan is particularly disturbing since the issues have been well known to the Department for many years.

17.117 We believe that a significant risk remains that the pathologies afflicting the Innu community will simply be transferred to the new location at Little Sango Pond, despite spending some $113 million.

Development of the relocation infrastructure

17.118 The MIRA designates the Department as the project leader for the relocation. In this capacity, the Department has the authority for all decisions pertaining to Canada's interest in all matters relating to the planning, design and construction of the project.

17.119 The overall implementation of the project is being carried out under the control and direction of the Mushuau Innu, through a project manager selected by the Innu in consultation with the Department. The powers and duties of the project manager are determined jointly by the Innu and the Department. These include implementing the project, reviewing and updating cost estimates, monitoring project cost, quality and progress and, where appropriate, recommending corrective action to the Mushuau Innu and the Department. We noted that the Department had not evaluated the capacity of the Innu to manage such a large and complex project prior to establishing the roles of the parties under the MIRA.

17.120 Further, we are concerned that although the Department estimated in 1996 that the relocation costs could reach about $110 million, it started the project with financing of $82 million, the maximum amount initially authorized.

This approach, in our view, is not consistent with sound project management.

17.121 We found that as at July 1999, the estimated cost had escalated to $113 million. The Department attributes most of this increase of $31 million, or about 35 percent, to higher project management and related project costs, including:

- capacity building for the Innu through their participation as an integral part of the project management and construction teams;
- an increase of 33 percent in the number of houses to be built;
- changes in technical standards for sewage lagoons and energy needs;
- increased costs of telecommunication services; and
- changes in standards and needs for various municipal and other buildings.

17.122 While it is not unusual for the initial cost estimates of certain components to be revised as better information becomes available, the costs of capacity building, housing needs and some other items attributed to the cost escalation should have been better anticipated.

17.123 Departmental information also showed that the project was one year behind its five-year schedule as of April 2000. The reported reasons for delays include problems relating to the selection of a project manager, disagreement over tendering practices for construction, redesigns arising from requests for larger facilities and strained relations among some of the parties.

17.124 Any delay means that the Innu continue to live in substandard conditions while they remain exposed to social risks. The Department has noted that the planned relocation date of fall 2001 is at risk.

Conclusion

17.125 The Department needs to take adequate steps to ensure that the relocation will achieve the intended results of remedying the known social pathologies in the Innu community. In addition, it needs to ensure the timely completion of the physical relocation within approved cost levels. Finally, we believe that the Department needs to become more actively involved with the project to help ensure success, while supporting the role of the Innu.

Indian and Northern Affairs Canada's response: *In responding to the social problems experienced by the Mushuau Innu of Davis Inlet, the federal government shared the Innu's objective of restoring a healthy, productive, independent society. The relocation project was, and still is, a key element in achieving this objective. Since 1999, federal and provincial partners have insisted on increased accountability by Innu leadership for funds provided for construction, healing and social projects.*

The various federal and provincial agencies recognize the Department's leadership role and are anxious to see this community rejuvenated. To increase its capacity to respond, Indian and Northern Affairs Canada's Atlantic Region has recently created a new directorate to manage all Newfoundland and Labrador files, including the Davis Inlet Relocation Project. One of the key priorities of this organization will be to enhance healing and capacity measures by working jointly with the Mushuau Innu. Concurrent with organizing the directorate, a new plan for remediating the health and social problems will be developed, in concert *with the Mushuau Innu and federal and provincial departments.*

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